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## Three's a Crowd or a Charm? Third Party Liability for Participating in Breaches of Fiduciary Duty

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# Three's a Crowd or a Charm? Third Party Liability for Participating in Breaches of Fiduciary Duty

ALISON GURR\*

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## ABSTRACT

This Article explores some previously unexamined questions surrounding the tort of third party liability for participating in breaches of fiduciary duty (TPLFD), which has been recognized in over half of the U.S. states. Should third parties be held liable for participating in breaches of fiduciary duty? If so, in states that have not yet adopted this form of liability, are there other existing causes of action that might address similar concerns and therefore render the introduction of TPLFD unnecessary? How should these states adopt this cause of action: via judicial development of the law, or through legislative reform? What are the key issues for the courts and legislators to consider when formulating this cause of action? This Article argues that states that have not yet adopted TPLFD should consider doing so through legislative reform. This will enable the states to address some of the key issues that have arisen in TPLFD case law.

## INTRODUCTION

*Imagine the following scenarios:*

- (a) *An accountant knowingly assists a trustee to siphon trust funds from a trust, in breach of the trustee's fiduciary duty of loyalty (Trust Scenario).*
- (b) *A bank assists two partners to breach their fiduciary duty to the third partner in the partnership by selling the partnership's remaining assets in lieu of foreclosure without the third partner's*

*consent and improperly paying the proceeds to the two partners rather than the partnership (Partnership Scenario).<sup>1</sup>*

In the above scenarios, whether the accountant and bank are held liable for losses resulting from the actions of the trustee and two partners will depend on the state in which the relevant conduct occurs. In some states, the accountant and bank would be held liable for participating in a breach of fiduciary duty. However, in other states that do not recognize this cause of action, the accountant and bank may escape liability, even though they knew that they were assisting in wrongful conduct and may have benefitted from it. As a result, if the defaulting trustee and partners are impecunious or cannot be sued for some other reason, the beneficiary of the trust and the third party may be left without compensation for losses arising out of the relevant breach of fiduciary duty.

Third party liability for participating in, or “aiding and abetting,”<sup>2</sup> a breach of fiduciary duty (TPLFD) is a cause of action that is receiving increasing recognition in the United States. For example, the Supreme Court of New Mexico recognized this cause of action in 1997,<sup>3</sup> the Supreme Court of Nevada in 2011,<sup>4</sup> and the Missouri Court of Appeals did so as recently as June 2013.<sup>5</sup> As of January 2015, this cause of action appears to have been adopted by courts of varying degrees of authority in approximately twenty-eight states.<sup>6</sup> However, in the remaining U.S. jurisdictions, courts

1. This factual situation is based on *Whitney v. Citibank*, 782 F.2d 1106, 1107–15 (2d Cir. 1986).

2. Courts vary in their use of terminology when describing this cause of action. They use terms such as “aiding and abetting,” “participating,” and “assisting” in a breach of fiduciary duty. See cases cited *infra* note 6.

3. *GCM, Inc. v. Ky. Cent. Life Ins. Co.*, 947 P.2d 143, 147–48 (N.M. 1997) (“While we believe New Mexico has implicitly endorsed tort liability for intentionally causing a fiduciary to breach his or her duties, we now explicitly recognize this form of tort liability.”).

4. *In re Amerco Derivative Litig.*, 252 P.3d 681, 701–02 (Nev. 2011).

5. *Nickell v. Shanahan*, No. ED99163, 2013 WL 2402852, at \*7 (Mo. Ct. App. June 4, 2013).

6. See, e.g., *Arkansas (Springdale Diagnostic Clinic v. Nw. Physicians*, No. CA03-103, 2003 WL 22138591, at \*4 (Ark. Ct. App. Sept. 17, 2003)); *California (Casey v. U.S. Bank Nat’l Ass’n*, 26 Cal. Rptr. 3d 401, 405 (2005)); *Colorado (Anstine v. Alexander*, 128 P.3d 249, 255 (Colo. Ct. App. 2005), *rev’d*, 152 P.3d 497 (Colo. 2007)); *Connecticut (Katcher v. 3V Capital Partners LP*, No. X05CV085008383S, 2011 WL 1105724, at \*14 (Conn. Super. Ct. Feb. 1, 2011); *Delaware (Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001)); *Florida (Nerbonne, N.V. v. Lake Bryan Int’l Props.*, 689 So.2d 322, 325 (Fla. Dist. Ct. App. 1997)); *Illinois (Crawford Supply Grp., Inc. v. Bank of Am.*, 829 F. Supp. 2d 636, 642 (N.D. Ill. 2011)); *Iowa (Rowen v. Le Mars Mut. Ins.*

have either expressly rejected this cause of action,<sup>7</sup> have left the issue open,<sup>8</sup> or have not addressed the issue at all.<sup>9</sup> TPLFD has been recognized at the federal level, primarily in the context of knowing participation in a breach of fiduciary duty under the Employee Retirement Income Security Act of 1974 (ERISA).<sup>10</sup>

Generally, to establish TPLFD: (1) there must be a breach of the fiduciary duty;<sup>11</sup> (2) the third party must have knowledge of that breach; (3) the third party must have assisted in the breach; and (4) the person to whom the fiduciary duty is owed—who will be referred to as the *beneficiary*—

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Co. of Iowa, 282 N.W.2d 639, 654 (Iowa 1979)); Kentucky (*Steelvest, Inc. v. Scansteel Serv. Ctr., Inc.*, 807 S.W.2d 476, 485 (Ky. 1991)); Massachusetts (*Arcidi v. Nat'l Ass'n of Gov't Emps., Inc.*, 856 N.E.2d 167, 174 (Mass. 2006)); Michigan (*In re Goldman Estate*, 601 N.W.2d 126, 128 (Mich. 1999)). *But see* *El Camino Res., Ltd. v. Huntington Nat'l Bank*, 712 F.3d 917, 922 (6th Cir. 2013); Minnesota (*Park Midway Bank v. R.O.A., Inc.*, No. A11-2092, 2012 WL 3263866, at \*3 (Minn. Ct. App. Aug. 13, 2012); Mississippi (*Knox Glass Bottle Co. v. Underwood*, 89 So.2d 799, 820 (Miss. 1956)); Missouri (*Nickell*, 2013 WL 2402852, at \*7); Nebraska (*Trieweller v. Sears*, 689 N.W.2d 807, 835 (Neb. 2004)); Nevada (*In re Amerco*, 252 P.3d at 701–02); New Jersey (*Bondi v. Citigroup, Inc.*, No. BER-L-10902-04, 2005 WL 975856, at \*18 (N.J. Super. Ct. Law Div. Feb. 28, 2005)); New Mexico (*GCM, Inc.*, 947 P.2d at 147–48); New York (*Kaufman v. Cohen*, 760 N.Y.S.2d 157, 169 (2003)); Oregon (*Reynolds v. Schrock*, 142 P.3d 1062, 1065–71 (Or. 2006)); Pennsylvania (*Lichtman v. Taufer*, No. 005560MARCHTERM 2004, 2004 WL 1632574, at \*8 (Pa. Com. Pl. July 13, 2004)); Court-Appointed Receiver of Lancer Mgmt. Grp. LLC v. Lauer, No. 05-60584CIV, 2008 WL 906274, at \*5 (S.D. Fla. Mar. 31, 2008)); South Dakota (*Chem-Age Indus., Inc. v. Glover*, 652 N.W.2d 756, 773–75 (S.D. 2002)); Tennessee (*In re Del-Met Corp.*, 322 B.R. 781, 816 (Bankr. M.D. Tenn. 2005)); Texas (*Hendricks v. Thornton*, 973 S.W.2d 348, 372 (Tex. App. 1998)); Utah (*Mower v. Simpson*, 278 P.3d 1076, 1087–88 (Utah App. 2012)); Washington (*Vanguard Int'l, Inc. v. Guangdong Fully, Ltd.*, 142 Wash. App. 1026 (2008)); Wisconsin (*Grad v. Associated Bank*, 801 N.W.2d 349 (Wisc. App. 2011)); Wyoming (*Voss Oil Co. v. Voss*, 367 P.2d 977, 980 (Wyo. 1962)).

7. Two states have expressly refused to recognize TPLFD. *See, e.g.*, Alabama (*Cont'l Cas. Co. v. Compass Bank*, No. Civ.A.04-0766-KD-C, 2006 WL 566900, at \*11 (S.D. Ala. Mar. 6, 2006), *cited with approval*, in *Laddin v. Belden (In re Verilink Corp.)*, 405 B.R. 356, 380 (Bankr. N.D. Ala. 2009)); Georgia (*In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 318 (S.D.N.Y. 2004)).

8. *See, e.g.*, Indiana (*DiMaggio v. Rosario*, 950 N.E.2d 1272, 1275–76 (Ind. Ct. App. 2011)); District of Columbia (*Pietrangelo v. Wilmer Cutler Pickering Hale & Dorr, LLP*, 68 A.3d 697, 711 (D.C. 2013)); and North Carolina (*Gusinsky v. Flanders Corp.*, No. 12 CVS 337, 2013 WL 5435788, at \*10, n.38 (N.C. Super. Sept. 25, 2013)).

9. For example, the courts in Alaska, Maine, Montana, New Hampshire, and Rhode Island do not appear to have considered this cause of action at all.

10. *See, e.g.*, *Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 245 (2000).

11. *See infra* p. 616 for a description of fiduciary duties. In *RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 874 (Del. 2015), the Delaware Supreme Court held that third parties can be held liable for aiding and abetting a breach of fiduciary duty even if the directors who committed the breach are protected from monetary damages under 8 Del. C. Section 102(b)(7); *see* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

must have suffered damage as a result of the breach.<sup>12</sup> The third party may be an individual, such as a professional agent or relative of the defaulting fiduciary, or a corporate entity, such as a bank<sup>13</sup> or parent company.<sup>14</sup>

A range of remedies may be available to plaintiffs who successfully establish TPLFD.<sup>15</sup> If liability is established, third parties are generally held jointly and severally liable with the fiduciary for losses arising out of the relevant breach.<sup>16</sup> In addition to compensatory damages, equitable

12. See, e.g., *In re Sharp Int'l Corp.*, 403 F.3d 43, 49–50 (2d Cir. 2005) (summarizing the position under New York law). It is not clear whether “damage” must be established in all jurisdictions. See, e.g., *Adena, Inc. v. Cohn*, 162 F. Supp. 2d 351, 357–58 (E.D. Pa. 2001) (setting out the elements of the test without any reference to damage: “[t]o establish a claim of aiding and abetting a breach of fiduciary duty, a plaintiff must show: (1) a breach of fiduciary duty owed to another; (2) knowledge of the breach by the aider or abettor; and (3) substantial assistance or encouragement by the aider or abettor in effecting that breach.”). Note that it has been suggested that there is an additional form of liability for aiding and abetting a breach of fiduciary duty that arises where “the aider and abettor owe a fiduciary duty to the victim and requires only that the aider and abettor provide substantial assistance to the person breaching his or her fiduciary duty.” *Am. Master Lease LLC v. Idanta Partners*, No. B244689, 2014 WL 715876, at \*13 (Cal. Ct. App. Feb. 25, 2014). This Article does not consider this form of liability.

13. In relation to banks, see for example, *In re First Alliance Mortg. Co.*, 471 F.3d 977, 995 (9th Cir. 2006) (“[O]rdinary business transactions a bank performs for a customer can satisfy the substantial assistance element . . . if the bank actually knew that those transactions were assisting the customer in committing a specific tort. Knowledge is the crucial element.” (citations omitted)); cf. *Glidden Co. v. Jandernoa*, 5 F. Supp. 2d 541, 556–57 (W.D. Mich. 1998) (“The Court is aware of no authority for holding a bank liable for financing a client’s business undertaking on the basis that the client might be engaged in fraud or breaches of fiduciary duty. A bank cannot be held liable for aiding and abetting fraud or breach of fiduciary duty merely on the basis that it knew that the party it was lending to was not being forthright in its dealings with others. Where, as here, there are no allegations or evidence that the Banks themselves made any misrepresentations or took any actions to affirmatively hide their client’s misdeeds, there is no basis for holding the Banks liable for aiding and abetting or conspiracy . . .”).

14. In relation to parent companies, which have been held liable for aiding and abetting breach of their subsidiaries’ directors duties, see for example, *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1038 (Del. Ch. 2006) (“[I]t is uncontroversial for parent corporations to be subjected to claims for aiding and abetting breaches of fiduciary duty committed by directors of their subsidiaries”); *ASARCO LLC v. Ams. Mining Corp.*, 396 B.R. 278, 413 (Bankr. S.D. Tex. 2008).

15. *ASARCO LLC v. Ams. Mining Corp.*, 404 B.R. 150, 157 (Bankr. S.D. Tex. 2009) (noting that under New Jersey law, the courts had a “degree of flexibility” when determining remedies for TPLFD.).

16. *LaSala v. Bordier et Cie*, 519 F.3d 121, 129 (3d Cir. 2008) (citing *Gotham Partners v. Hallwood Realty Partners*, 817 A.2d 160, 173 (Del. 2002) (describing the remedy for TPLFD as “become jointly and severally liable to make good on any loss to the corporation attributable to the disloyalty”); *Wechsler v. Bowman*, 34 N.E.2d 322, 326

relief such as rescission,<sup>17</sup> “the restitutionary remedies of unjust enrichment and disgorgement,” which enable plaintiffs to strip third parties of wrongful gains arising from their participation in the fiduciary breach,<sup>18</sup> and the imposition of constructive trusts over specific property or money that was obtained in breach of fiduciary duty,<sup>19</sup> may also be available. In rare cases, punitive damages may be awarded.<sup>20</sup> There is some uncertainty surrounding whether TPLFD is a tort or an equitable wrong.<sup>21</sup>

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(N.Y. 1941); *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993) (“It is also true that money damages were available in those courts against the trustee . . . and against third persons who knowingly participated in the trustee’s breach.” (citations omitted)).

17. *ASARCO LLC*, 404 B.R. at 168 (ordering “return of the stock and dividends, plus prejudgment interest on those dividends.”).

18. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 874 cmt. c (AM. LAW INST. 1979) (“The measure of his liability, however, may be different from that of the fiduciary since he is responsible only for harm caused or profits that he himself has made from the transaction, and he is not necessarily liable for the profits that the fiduciary has made nor for those that he should have made.”); *ASARCO LLC*, 404 B.R. at 169; *Am. Master Lease LLC v. Idanta Partners*, No. B244689, 2014 WL 715876, at \*16–17 (Cal. Ct. App. Feb. 25, 2014) (citations omitted) (“‘Disgorgement of profits is particularly applicable in cases dealing with breach of a fiduciary duty, and is a logical extension of the principle that public officials and other fiduciaries cannot profit by a breach of their duty . . .’ Even though the defendant was not in a fiduciary relationship with the county, the court held that his ‘[a]ctive participa[tion] in the breach of fiduciary duty by another [rendered him] accountable for all advantages [he] gained thereby . . . .’” (quoting *Cty. of San Bernardino v. Walsh*, 69 Cal. Rptr. 3d 848, 856–57 (2007))).

19. *Teachers’ Ret. Sys. v. Aidinoff*, 900 A.2d 654, 671–72 (Del. Ch. 2006) (“As a result, the pled facts make out a claim for aiding and abetting a breach of fiduciary duty against Starr, as Starr is fairly charged with the knowledge and conduct of its controlling persons. Second, to the extent that Starr’s controllers intentionally enriched Starr excessively to the detriment of AIG, the relationship between Starr and AIG is such that a claim for unjust enrichment might later be sustained. Either of these claims, if proven after trial, could theoretically support the imposition of a constructive trust.”); *see also Jackson Nat’l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 393–94 (Del. Ch. 1999) (“If Plaintiffs succeed on the merits of their breach of fiduciary duty and aiding and abetting claims, it is likely they will also be able to prove that neither Kennedy nor Fort James can retain any benefit resulting from the disputed transaction ‘justifiably’ or in accordance with ‘the fundamental principles of justice or equity and good conscience.’ Plaintiffs, therefore, properly state an actionable claim for unjust enrichment and imposition of a constructive trust.”); *ASARCO LLC*, 404 B.R. at 169.

20. *See, e.g., Whitney v. Citibank*, 782 F.2d 1106, 1118 (2d Cir. 1986). The Court of Appeal’s decision in this case to uphold a \$1,500,000.00 punitive damages award against Citibank for its knowing participation in a breach of fiduciary duty, has been questioned in subsequent cases. *See, e.g., In re W. 56th St. Associates*, 181 B.R. 720, 725–26 (Bankr. S.D.N.Y. 1995); *see also ASARCO LLC v. Ams. Mining Corp.*, 396 B.R. 278, 421 (Bankr. S.D. Tex. 2008) (“[P]unitive damages are available for breach of fiduciary duty and aiding and abetting a breach of fiduciary duty.”).

21. This question is relevant to determining whether a defendant accused of participating in a breach of fiduciary duty is entitled to trial by jury. *See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 723 (1999) (Scalia, J., concurring in part and concurring in the judgment). The Restatement (Second) of Torts describes TPLFD

The *knowledge* and *assistance* elements of the above test and the question of whether attorneys should be immune from such liability have received

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as a “tort” (and breach of fiduciary duty itself is also described as a tort). RESTATEMENT (SECOND) OF TORTS § 874 (AM. LAW INST. 1982). However, in *Damage Recovery Sys., Inc. v. Tucker*, No. CIV.02-1647-SLR, 2005 WL 388597, at \*2 (D. Del. Feb. 2, 2005), a United States District Court stated that “[i]f the underlying action is equitable in nature, a claim of aiding and abetting that underlying cause of action must also be equitable. In this case the fact that a breach of fiduciary duty claim is equitable in nature makes plaintiff’s claim that defendant aided and abetted a breach of fiduciary duty equitable as well.” As a result, the court refused the defendant’s request for a trial by jury with respect to the aiding and abetting breach of fiduciary duty claim. *Id.* Similarly, in *Crawford Supply Grp., Inc. v. Bank of Am.*, 829 F. Supp. 2d 636, 643 (N.D. Ill. 2011), another United States District Court held that participation in a breach of fiduciary duty is an “equitable claim;” and in *Cantor v. Perelman*, No. CIV.A. 97-586-KAJ, 2006 WL 318666 (D. Del. Feb. 10, 2006), the court said “the Plaintiffs’ claims [for breach of fiduciary duty and for aiding and abetting that breach] are historically equitable.” However, it is not clear that this outcome reflects the law in other jurisdictions. This is because state courts differ on the nature of a breach of fiduciary duty. *See, e.g.*, *Zastrow v. Journal Commc’ns, Inc.*, 718 N.W.2d 51, 62 (Wis. 2006). Breach of the fiduciary duty of loyalty has been considered an intentional tort in some jurisdictions. *Posner v. Essex Ins. Co.*, 178 F.3d 1209, 1219 (11th Cir. 1999) (“[B]reach of a fiduciary duty is a tort”); *Zastro*, 718 N.W.2d at 62 (“Why does the law conclude that the breach of a fiduciary duty of loyalty is an intentional tort? It does so because the fiduciary consciously agreed to be committed to the interests of those to whom the fiduciary assumed that special role.”); *Schafer v. RMS Realty*, 741 N.E.2d 155, 197 (Ohio Ct. App. 2000) (“[P]unitive damages can be awarded for breach of fiduciary duty, just like other intentional torts, upon proof of actual or implied malice.”); RESTATEMENT (SECOND) OF TORTS § 874 (AM. LAW INST. 1979). It has also been considered an “equitable wrong,” *Williams Elecs. Games, Inc. v. Garrity*, 366 F.3d 569, 577–78 (7th Cir. 2004), or a cause of action arising out of the “law of agency, contract, and equity.” *Kinzer v. City of Chicago*, 539 N.E.2d 1216, 1220 (Ill. 1989); *Bankard v. First Carolina Commc’ns, Inc.*, No. 89 C 8571, 1991 WL 268652, at \*11 (N.D. Ill. Dec. 5, 1991). *See also* J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 71 (2010) (“[B]reach of a fiduciary duty is in fact a tort, although a unique species historically called an ‘equitable tort.’”). In addition, some cases suggest that whether a breach of fiduciary claim is an equitable claim will depend on whether the plaintiff is “seeking compensatory damages (a legal remedy) from a claim seeking restitution (an equitable remedy).” *Soley v. Wasserman*, No. 08 CIV. 9262 KMW FM, 2013 WL 1655989, at \*2 (S.D.N.Y. Apr. 17, 2013) (citing *Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2005)). In the context of aiding and abetting fraud, some courts have suggested that there is no “separate tort” of aiding and abetting. *See, e.g.*, *E. Trading Co. v. Refco, Inc.*, 229 F.3d 617, 623–24 (7th Cir. 2000) (“We have said that there is no tort of aiding and abetting . . . but of course without meaning that one who aids and abets a tort has no liability. The distinction is between a separate tort of aiding and abetting, and aiding and abetting as a basis for imposing tort liability.” (citations omitted)).



some academic attention.<sup>22</sup> However, there is a striking lack of commentary regarding other issues surrounding this form of liability. In particular, the threshold question of whether this cause of action should be adopted in states where it has not been recognized has been largely unexplored. This question is topical because, as noted above, there appears to be a growing trend by state courts to recognize this as a new cause of action.<sup>23</sup> It is also important because fiduciary duties arise in a range of different contexts.<sup>24</sup> Directors, trustees, employees, and partners have fiduciary duties and fiduciary duties have even been found to arise in some personal relationships, such as between parents and children.<sup>25</sup> Accordingly, holding third parties liable for participating in breaches of fiduciary duties can have far reaching consequences.<sup>26</sup>

Part I of this Article will consider the threshold question noted above: Should third parties be held liable for participating in breaches of fiduciary duty? After establishing that there are justifications for this liability, Part II will explore whether there are other existing causes of action that might address similar concerns and therefore render the introduction of TPLFD unnecessary. Part III will consider *how* TPLFD should be recognized in states that have not yet adopted this cause of action. It will also argue that the courts, and not the legislature, should introduce TPLFD. Finally, Part IV will set out some key issues for the courts and legislators to consider when formulating this cause of action.

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22. See, e.g., Kevin Bennardo, *The Tort of Aiding and Advising?: The Attorney Exception to Aiding and Abetting a Breach of Fiduciary Duty*, 84 N.D. L. REV. 85 (2008); Nathan Isaac Combs, *Civil Aiding and Abetting Liability*, 58 VAND. L. REV. 241 (2005); Ronald M. Lepinkas, *Civil Aiding and Abetting Liability In Illinois*, 87 ILL. B.J. 532 (1999); Katerina P. Lewinbuk, *Let's Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client's Breach of Fiduciary Duty*, 40 ARIZ. ST. L.J. 135 (2008); Richard C. Mason, *Civil Liability for Aiding and Abetting*, 61 BUS. LAW. 1135 (2006); Stanley Pietrusiak, Jr., *Changing the Nature of Corporate Representation: Attorney Liability for Aiding and Abetting the Breach of Fiduciary Duty*, 28 ST. MARY'S L.J. 213 (1996); Eugene J. Schiltz, *Civil Liability for Aiding and Abetting: Should Lawyers Be "Privileged" to Assist Their Clients' Wrongdoing?*, 29 PACE L. REV. 75 (2008).

23. Bryan C. Barksdale, *Redefining Obligations in Close Corporation Fiduciary Representation: Attorney Liability for Aiding and Abetting the Breach of Fiduciary Duty in Squeeze-Outs*, 58 WASH. & LEE L. REV. 551, 554 (2001).

24. Tamar Frankel, *Fiduciary Duties*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127, 127 (Peter Newman ed., 1998).

25. *Boyd v. Boyd*, 545 S.W.2d 520, 524 (Tex. Civ. App. 1976).

26. See Royce de R. Barondes, *Fiduciary Duties in Distressed Corporations: Second-Generation Issues*, J. BUS. & TECH. L. 371, 371 (2007).

## I. SHOULD THIRD PARTIES BE HELD LIABLE FOR PARTICIPATING IN BREACHES OF FIDUCIARY DUTY?

There are pragmatic and principled justifications for holding third parties who participate in a breach of fiduciary duty liable: to protect fiduciary relationships and the proprietary interests of beneficiaries; to prevent exploitation for gain; to address wrongful or unconscionable conduct; and to provide compensation to beneficiaries who have suffered loss as a result of the fiduciary breach.<sup>27</sup> However, there are also concerns that TPLFD may harm innocent third parties and beneficiaries.<sup>28</sup> The advantages and disadvantages of TPLFD are discussed below.

### A. Arguments in Favor of TPLFD

#### 1. Protect Fiduciary Relationships and Proprietary Interests of Beneficiaries

One of the primary objectives of TPLFD is to protect fiduciary relationships and the proprietary interests of beneficiaries.<sup>29</sup> As discussed below, fiduciary relationships have special characteristics that may justify heightened protection from third parties.<sup>30</sup>

Fiduciary relationships can arise in one of two ways. Some relationships are recognized as fiduciary in nature as a matter of law: trustee–beneficiary, guardian–ward, attorney–client, partner–partner, agent–principal, and director–

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27. Some of these justifications were neatly summarized in a case before the Australian High Court. *Zhu v Treasurer of NSW* (2004) 218 CLR 530, 571 (Austl.) (“Intervention against a third party who obtains trust property from a trustee in breach of trust is based on the need to protect the proprietary interests of the beneficiaries. Intervention against a third party who obtains some other advantage as a result of a trustee’s breach of trust is based on the need to ensure that the trust receives property which, if it were to be acquired at all, should have been acquired for the trust. Intervention against persons who knowingly assist other fiduciaries to breach their duty is based on the need to deter conduct that directly undermines the ‘high standard’ required of fiduciaries, and on the inequitable character of permitting those persons to retain benefits resulting from their conduct.” (quoting *Consul Dev v DPC Estates* (1975) 132 CLR 373, 397 (Austl.)).

28. See *infra* Part I.B.

29. See *infra* text accompanying note 46.

30. See Paul B. Miller, *A Theory of Fiduciary Liability*, 56 MCGILL L.J. 235, 240 (2011).

corporation relationships.<sup>31</sup> In addition, the courts may find that fiduciary duties arise in other types of relationships by drawing analogies with existing fiduciary relationships.<sup>32</sup> Typically, fiduciary relationships arise where “one has reposed trust or confidence in the integrity or fidelity of another who thereby gains a resulting superiority of influence over the first, or when one assumes control and responsibility over another”<sup>33</sup> or where one “is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation.”<sup>34</sup> The vulnerability of the person who has reposed trust or confidence in another or for whom another has undertaken a duty to act for is often a key factor in determining whether a fiduciary relationship exists.<sup>35</sup>

Fiduciaries are generally entrusted with the property of, or power over, beneficiaries.<sup>36</sup> As a result, beneficiaries are exposed to the risk that fiduciaries will misappropriate the relevant property or abuse the power vested in them.<sup>37</sup> This risk is increased because in many fiduciary relationships monitoring the fiduciary’s performance would be prohibitively expensive or impractical, particularly where the fiduciary’s role requires specialized or technical skills or knowledge.<sup>38</sup> For example, in the attorney–client context, it will generally be difficult for clients to determine whether their attorney is performing satisfactorily unless the client is an in-house lawyer who has knowledge of the relevant area of the law and the time to monitor the attorney’s performance—and even in this case, monitoring is unlikely to be efficient.<sup>39</sup> For these reasons, beneficiaries are typically dependent on and vulnerable to fiduciaries.<sup>40</sup>

To reduce the high monitoring costs and risks of misappropriation of property and abuse of power, the law imposes fiduciary duties on fiduciaries

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31. See *GAB Bus. Servs. v. Lindsey & Newsom Claim Servs.*, 99 Cal. Rptr. 2d 665, 669 (Cal. Ct. App. 2000).

32. Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 804 (1983). These types of fiduciary relationships are sometimes referred to as “confidential relationships.” See *id.* at 825 n.100.

33. *Reuben H. Donnelley Corp. v. Mark I Mktg. Corp.*, 893 F. Supp. 285, 289 (S.D.N.Y. 1995) (citing *Teachers Ins. & Annuity Ass’n of Am. v. Wometco Enters., Inc.*, 833 F. Supp. 344, 349–50 (S.D.N.Y. 1993)).

34. RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (AM. LAW. INST. 1979).

35. See, e.g., *Richelle L. v. Roman Catholic Archbishop*, 130 Cal. Rptr. 2d 601, 611 (Cal. Ct. Appl. 2003) (citing GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 482, at 288–89 (rev. 2d ed. 1978)); *City of Hope Nat’l Med. Ctr. v. Genentech, Inc.*, 181 P.3d 142, 152 (Cal. 2008).

36. See Frankel, *supra* note 24.

37. *Id.*

38. See Tamar Frankel, *Fiduciary Law in the Twenty-First Century*, 91 B.U. L. REV. 1289, 1297 (2011).

39. See Frankel, *supra* note 24, at 128.

40. Frankel, *supra* note 32, at 810.

to deter wrongdoing.<sup>41</sup> While some courts have suggested that there are three fiduciary duties of “good faith, loyalty or due care,”<sup>42</sup> the better view is that there is only one fiduciary duty: the duty of loyalty which requires fiduciaries to refrain from acting in his or her own self-interest, amongst other things.<sup>43</sup> There is judicial support for the view that duty of “good

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41. Numerous rationales have been given for justifying fiduciary law. See, e.g., Ray Ryden Anderson & Walter W. Steele, Jr., *Fiduciary Duty, Tort and Contract: A Primer on the Legal Malpractice Puzzle*, 47 SMU L. REV. 235, 242–43 (1994) (citations omitted) (“Scholars have examined several competing theories as justification for fiduciary law, including the so-called property theory, the reliance theory, the unequal relationship theory, the contractual theory, the unjust enrichment theory, the commercial utility theory, and the power and discretion theory. Although there is no consensus on the one dominant or most correct theory, the fundamental focus of all of these theories is the beneficiary’s transfer of power to the principle encumbered by accompanying duties.”).

42. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994), *cited with approval in* Heritage Org., L.L.C. v. Kornman (*In re* The Heritage Org., L.L.C.), Case No. 04-35574-BJH-11, Adv. No. 06-3377-BJH, 2008 WL 5215688, at \*15 (Bankr. N.D. Tex. Dec. 12, 2008); see also *In re* TEU Holdings, Inc., 287 B.R. 26, 32 (Bankr. D. Del. 2002) (citing Kahn v. Dairy Mart Convenience Stores, Civ. A. No. 12489, 1994 WL 89010, at \*2 (Del. Ch. Mar. 1, 1994)); Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) (citing Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998)); Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)); Kahn v. Dairy Mart Convenience Stores, Civ. A. No. 12489, 1994 WL 89010 (Del. Ch. Mar. 1, 1994) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)); cf. Lintgeris v. Lintgeris, No. UWYCV085008846S, 2009 WL 1815058, at \*2 (Conn. Super. Ct. June 3, 2009) (citations omitted) (“The fiduciary duty comprises two prongs: a duty of care and a duty of loyalty. While the duty of care requires that fiduciaries exercise their best care and judgment, the duty of loyalty derives from the prohibition against self-dealing that inheres in the fiduciary relationship.”); see the discussion in Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231 (2010), suggesting there should be five fiduciary duties.

43. See, e.g., Daugherty v. Runner, 581 S.W.2d 12, 16 (Ky. Ct. App. 1978) (“Since the relationship of attorney-client is one fiduciary in nature, the attorney has the duty to exercise in all his relationships with this client-principal the most scrupulous honor, good faith and fidelity to his client’s interest.”); Tyson v. Moore, 613 So. 2d 817, 823 (Miss. 1992) (“The duty of loyalty is fiduciary in nature.”); Zastrow v. Journal Commc’ns, Inc., 718 N.W.2d 51, 59–61 (Wis. 2006) (citations omitted) (“[T]he duty of loyalty is broader than simply requiring the fiduciary to refrain from acting in his own self-interest. . . . For example, it also may require keeping a beneficiary’s information confidential . . . and fully disclosing to the beneficiary all information relevant to the beneficiary’s interest. . . . The fiduciary’s duty of loyalty is ‘to act solely for the benefit of the principal in all matters connected with the agency, even at the expense of the agent’s own interests.’”); RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006) (“An agent has a fiduciary duty to act loyally for the principal’s benefit in all matters connected with the agency relationship.”). The scope of the relevant fiduciary duties may also vary depending on the fiduciary in question and may be modified by legislation. For example, the UNIFORM PARTNERSHIP

faith” is simply a subset of the duty of loyalty rather than a separate fiduciary duty,<sup>44</sup> and while many fiduciaries may owe duties of care to their beneficiaries, these duties are not fiduciary in nature.<sup>45</sup>

TPLFD protects fiduciary relationships and the proprietary interests of beneficiaries by deterring third parties from participating in breaches of

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ACT 1997 § 404(a) states that “[t]he only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).” *See also*, Christopher M. Bruner, *Is the Corporate Director’s Duty of Care a “Fiduciary” Duty? Does It Matter?*, 48 WAKE FOREST L. REV. 1027, 1038 (2013) (footnote omitted) (“[W]hile partnership law and corporate law style the duty of care a ‘fiduciary’ duty, agency law does not.”).

44. *See, e.g.*, *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (“First, although good faith may be described colloquially as part of a ‘triad’ of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly. The second doctrinal consequence is that the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.”); *Zastrow*, 718 N.W.2d at 62 (“We conclude that good faith is encompassed within what we have more succinctly referred to as the duty of loyalty that arises when a fiduciary role is accepted.”); *Guttman v. Huang*, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003) (“A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation’s best interest. For this reason, the same case that invented the so-called ‘triad[ ]’ of fiduciary duty, *see Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del.1993) (‘Cede II’), also defined good faith as loyalty. . . . It does no service to our law’s clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement.”); *see also Velasco*, *supra* note 42, at 1257–77.

45. *See, e.g.*, *James v. Chase Manhattan Bank*, 173 F. Supp. 2d 544, 550 (N.D. Miss. 2001) (“The Mississippi Supreme Court has recognized a distinction between the duty of care and the duty of loyalty owed the client; the latter is fiduciary in nature while the former is not.” (citing *Tyson v. Moore*, 613 So. 2d 817, 823 (Miss. 1992)); William A. Gregory, *The Fiduciary Duty of Care: A Perversion of Words*, 38 AKRON L. REV. 181, 189 (2005) (footnote omitted) (“Good faith is a fiduciary duty. Loyalty is a fiduciary duty. Due care is not.”); Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 250 (2009) (footnotes omitted) (“There is some debate about whether the duty of care is a fiduciary obligation at all. When the fiduciary duties are listed, it is traditionally included. However, many scholars have questioned this characterization of the duty of care. Some argue that it is not fiduciary in nature because fiduciary relationships have no particular or exclusive claim on the obligation to act with due care. The duty to act with the ‘minimum standard of skill, judgment, competence’ is not necessarily fiduciary and is found in many non-fiduciary relationships. While the duty of care may describe the behavior we want fiduciaries to exhibit, it is not a duty or obligation related particularly to fiduciary status.”); Bruner, *supra* note 43, at 1028, 1043 (noting that “the fundamental problem with Delaware’s conflation of care and loyalty is that it impedes recognition of the fact that these duties address different problems with different moral valences, calling for different enforcement regimes” and that in other common law jurisdiction, a fiduciary’s duty of care is not recognized as fiduciary in nature).

fiduciary duty, which may, in turn, deter or prevent fiduciary breach and the misappropriation of beneficiaries' property interests.<sup>46</sup> If a third party is deterred from providing *assistance*, this may reduce opportunities for a fiduciary to commit the breach. For example, if under the Trust Scenario described above the trustee needed the assistance of an accountant in order to siphon the trust funds, then TPLFD may make it difficult for the trustee to locate an accountant willing to provide that assistance given the risks of liability. If a third party is deterred from *inducing* or *procuring* a breach, then the fiduciary may not consider committing the breach at all. For example, if the defaulting partners in the Partnership Scenario only decided to sell the partnership assets without the third partner's consent after the bank suggested it, then TPLFD may have deterred the bank from making that suggestion and the sale would not have proceeded. The deterrence function of this cause of action is particularly important because of the nature of the fiduciary relationship TPLFD is designed to protect.

Most states have recognized that third parties who wrongfully induce a breach of contract should be held liable for their actions. As discussed in Section C of Part IV, there is a strong argument that fiduciary relationships, unlike contractual relationships, are characterized by vulnerability and an imbalance of power, and deserve at least the same, if not a greater, degree of protection.

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46. GCM, Inc. v. Ky. Cent. Life Ins. Co., 947 P.2d 143, 148 (N.M. 1997) (“[T]ort liability for aiding and abetting is consistent with one of the principal goals of tort law, the deterrence of wrongful actions that result in harm.”); ASARCO LLC v. Ams. Mining Corp., 404 B.R. 150, 168 (Bankr. S.D. Tex. 2009) (“Of utmost importance for the purposes of fashioning a remedy on an aiding and abetting a breach of fiduciary duty claim is the inequity inherent to any breach of fiduciary duty and the strong role the courts must play in deterring such breaches in the future.”). However, note the discussion in Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. REV. 377, 443 (1994), regarding whether tort law does in fact “deter”: “The information suggests that the strong form of the deterrence argument is in error. Yet it provides support for that argument in its moderate form: sector-by-sector, tort law provides something significant by way of deterrence.” Deterrence is more likely to be effective for torts such as TPLFD which involve some knowledge or intent element: “Since a conscious decision is taken by the accessory, there is clearly the opportunity to deter the accessory from becoming “involved” in the primary breach.” Paul S. Davies, *Accessory Liability for Assisting Torts*, 70 CAMBRIDGE L.J. 353, 361 (2011). It seems likely that the deterrent effect will be most successful with professional third parties, such as agents or banks, who are more likely to be aware of the consequences of participating in a breach of fiduciary duty.

## 2. Prevention of Exploitation for Gain

TPLFD can also be justified on the basis that it discourages and punishes third parties from exploiting beneficiaries for their own gain.<sup>47</sup> The desire to protect persons in positions of vulnerability from exploitation is a common theme in equity, which is reflected in other equitable principles such as undue influence and fiduciary law more generally. The gain based remedies, such as unjust enrichment and disgorgement, which may be available against third parties who have been enriched as a result of the fiduciary breach, prevents third party exploitation of beneficiaries' vulnerability for gain. However, in some jurisdictions it appears beneficiaries must establish damage in order to successfully bring an action for TPLFD.<sup>48</sup> The requirement for damage undermines the view of TPLFD as a device to prevent exploitation for gain, as it will not prevent exploitation of beneficiaries by third parties for gain where the beneficiary suffers no loss.

## 3. Wrongful or Unconscionable Conduct

TPLFD can be justified on the basis that knowingly or intentionally procuring, inducing, or assisting breach of another's legal obligation is *wrongful* or *unconscionable* conduct that should give rise to liability.<sup>49</sup> This rationale could be based in deontological principles of corrective justice that have been used to justify other torts,<sup>50</sup> or in equitable principles

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47. Pauline Ridge, *Justifying the Remedies for Dishonest Assistance*, 124 L. Q. REV. 445, 449 (2008).

48. For example, in *Taita Chem. Co. v. Westlake Styrene*, 351 F.3d 663, 670–71 (5th Cir. 2003), the plaintiff argued that in a situation where the third party had made a profit arising from the assistance, they must disgorge profits under TPLFD even though the plaintiff had not suffered any loss. The court rejected this argument, holding that “[u]nder Delaware law, damages are a required element of an aiding and abetting cause of action.” *Id.* at 670.

49. This rationale is discussed in an Australian context in Pauline Ridge, *Participatory Liability for Breach of Trust or Fiduciary Duty*, in *FAULT LINES IN EQUITY* 119, 136 (Jamie Glister & Pauline Ridge eds., 2012). See also RESTATEMENT (SECOND) OF AGENCY § 312 (1958) (noting that there is a “general rule that, unless there is a privilege to do so, a person is under a duty to refrain from intentionally causing another to violate a duty to a third”); GEORGE GLEASON BOGERT ET AL., *BOGERT’S TRUSTS AND TRUSTEES*, ch. 43, § 901 (updated Sept. 2015) (“Just as every owner of a legal interest has the right that others shall not, without lawful excuse, interfere with his possession or enjoyment of the property or adversely affect its value, so the beneficiary, as equitable owner of the trust res has the right that third persons shall not knowingly join with the trustee in a breach of trust.”).

50. For a discussion about the “corrective justice” rationales for tort law, see generally F. Patrick Hubbard, *The Nature and Impact of the “Tort Reform” Movement*, 35 *HOFSTRA L. REV.* 437, 446 (2006) (footnotes omitted) (“[o]ur sense of fairness requires

of good conscience.<sup>51</sup> Third party liability for wrongfully inducing a breach of contract is another example of liability that could be explained on these grounds.

#### 4. *Compensation*

TPLFD also has a compensatory function: it provides plaintiffs with another person to recover damages from if the fiduciary is impecunious or otherwise unable to pay.<sup>52</sup> When faced with a choice between the innocent plaintiff bearing the losses arising out of the fiduciary's wrongdoing, or the third party who *knowingly* or *intentionally* contributed to the plaintiff's loss, it is reasonable that the third party be liable for some, if not all, of the damage suffered by the plaintiff.<sup>53</sup>

#### B. *Arguments Against TPLFD*

However, TPLFD may have undesirable consequences. First, there is a concern that TPLFD may give rise to compliance costs for the third party and disrupt normal commercial activity.<sup>54</sup> For example, if the test effectively

that, as a matter of 'corrective justice,' victims who suffer injury because their rights have been wrongly denied should have recourse to a system that requires injurers to pay compensation. These injurers 'deserve' to bear the costs of their wrongs, not innocent victims. This concept of 'just desert' also serves to limit liability from becoming disproportionately large in comparison to a defendant's wrongdoing.").

51. *Id.* at 446–47 ("In terms of corrective justice, punitive awards provide vindication for the victim's rights where they have been violated by an exceptionally egregious wrong and satisfy a need for retribution for such conduct.").

52. *See, e.g.,* Royal Brunei Airlines Sdn. Bhd. v. Tan [1995] UKPC 4, [1995] 2 AC 378, 386–87 (PC) (noting by Lord Nicholls, in the context of holding third parties liable for breaches of fiduciary duties by trustees, that "[a]ffording the beneficiary a remedy against the third party serves the dual purpose of making good the beneficiary's loss should the trustee lack financial means and imposing a liability which will discourage others from behaving in a similar fashion."). This is consistent with the view that one of the purposes of tort law is to provide compensation. *See, e.g.,* Hubbard, *supra* note 50, at 445–47 ("[C]ompensation of victims is frequently said to be, by itself, a goal of tort law.").

53. *See, e.g.,* Davies, *supra* note 46, at 360 ("[T]he fact that the acts of the accessory did have some causal effect upon the primary wrong means that he should bear some responsibility for that wrong.").

54. Terrydale Liquidating Tr. v. Barness, 611 F. Supp. 1006, 1030 (S.D.N.Y. 1984) ("The nature of wrongdoing alleged in this case also supports a requirement that a party actually know that a breach of fiduciary duty is intended and consummated. Transactions which may appear reasonable at the time they are entered into may, upon more considered and deliberate reflection, prove to be objectively unreasonable. However, to impose affirmative liability on a purchaser in a commercial transaction without concrete evidence of both its



imposes a “duty to inquire” on third parties such as banks, accountants, or attorneys, these third parties may spend time and money monitoring for breaches of fiduciary or contractual obligations.<sup>55</sup> It may not be practicable for third parties to carry out these monitoring activities—particularly in the case of banks, which are sometimes accused of assisting breaches of fiduciary duties simply by engaging in normal banking activities such as transferring funds<sup>56</sup>—and these costs may be passed on to innocent parties. Second, there is a risk that TPLFD may capture innocent participants if the test to establish liability is not stringent enough.<sup>57</sup> Third, TPLFD may deter third parties from providing services that they see as risky but which may be beneficial for society.<sup>58</sup> For example, professional third parties might be reluctant to act for inexperienced trustees or other types of fiduciaries on the basis that they may be more likely to breach their fiduciary obligations, even though these fiduciaries may be most in need of their services.<sup>59</sup> Fourth, if the test for TPLFD requires that the third party has knowledge of the breach of fiduciary duty, professional advisors may be discouraged

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knowledge of the self-interest or bad faith of the seller and its unavoidable awareness of the transaction’s substantive unfairness or lack of business purpose would disrupt commercial activity in a manner wholly inconsistent with the purposes of aider and abettor liability.”)

55. See *infra* note 56 and accompanying text.

56. See, e.g., *Seaboard Sur. Co. v. State Sav. Bank of Ann Arbor*, 11 N.W.2d 321, 325–26 (Mich. 1943) (“Incident to the statement that it is not the business or duty of a bank to administer or supervise the administration of trust funds, it has been appropriately and rather forcibly pointed out: ‘Any other rule would throw upon a bank the duty of inquiring as to the appropriation made of every fund deposited by a trustee or other like fiduciary; and the imposition of any such a duty would practically put an end to the banking business, because no bank could possibly conduct business, if, without fault on its part, it were held accountable for the misconduct or malversations of its depositors who occupy some fiduciary relation to the fund placed by them with the bank.’ . . . [Banks] would be compelled to accept and administer the deposit at its peril or to act as a ‘super-snooper’ by way of investigating each transaction related to such an account. The banking business of the country should not be hampered or penalized by the adoption of so harsh a rule. . . . the bank has a right to presume that the fiduciary will apply the funds to their proper purposes under the trust.” (citations omitted)).

57. See, e.g., *Investors Research Corp. v. Sec. & Exch. Comm’n*, 628 F.2d 168, 177 (D.C. Cir. 1980) (“The awareness of wrong-doing requirement for aiding and abetting liability is designed to insure that innocent, incidental participants in transactions later found to be illegal are not subjected to harsh, civil, criminal, or administrative penalties.”).

58. See, e.g., *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 189 (1994).

59. See *id.* (noting, in the context of aiding and abetting liability in securities law, that aiding and abetting liability “can have ripple effects. For example, newer and smaller companies may find it difficult to obtain advice from professionals. A professional may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others. In addition, the increased costs incurred by professionals because of the litigation and settlement costs under 10b–5 may be passed on to their client companies, and in turn incurred by the company’s investors, the intended beneficiaries of the statute.”).

from being fully informed so that they do not incur liability.<sup>60</sup> As a result, they may be less likely to monitor for and potentially prevent wrongdoing, and the lack of information may undermine the quality of professional advice they provide.<sup>61</sup> These concerns are reflected in the arguments that have been made in favor of attorney immunity from TPLFD, discussed further in Part IV. Finally, TPLFD may increase the risk of frivolous litigation, and the risk that third parties may be held liable in error. Some of these concerns were noted by the Supreme Court in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*<sup>62</sup> in the context of aiding and abetting liability under the Securities Exchange Act of 1934, when it acknowledged that the uncertainty inherent in third party liability may cause—possibly innocent—third parties “as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial” and that it may encourage “excessive litigation” and give rise to “costs that may disserve the goals of fair dealing and efficiency in the securities markets.”<sup>63</sup>

However, as discussed in Part IV, many of the concerns highlighted above can be addressed by carefully tailoring the test to establish liability.<sup>64</sup> For this reason, the benefits associated with having TPLFD liability—with an appropriately crafted test—are likely to outweigh the concerns highlighted above.

## II. ARE THERE OTHER CAUSES OF ACTION THAT PROVIDE SUFFICIENT PROTECTION?

The justifications outlined in Part I suggest that there are strong reasons for TPLFD to be recognized in all U.S. jurisdictions.<sup>65</sup> However, in states where TPLFD has not been recognized, there may be other causes of action that may achieve similar results. If this is the case, then the adoption of TPLFD may not be necessary. In this section, alternative causes of action will be considered.

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60. See, e.g., Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1127 (2003).

61. *Id.*

62. *Cent. Bank of Denver*, 511 U.S. at 188–89.

63. *Id.*

64. See *infra* Part IV.

65. See *supra* Part I.

### A. Legislation

In some states, legislation may hold third parties liable for participating in breaches of fiduciary duty in specific circumstances. For example, the Official Code of Georgia Annotated § 51-12-30 provides that any person who “maliciously procures an injury to be done to another, whether an actionable wrong or a breach of contract, is a joint wrongdoer and may be subject to an action either alone or jointly with the person who actually committed the injury.”<sup>66</sup> In *Insight Tech., Inc. v. FreightCheck, LLC*,<sup>67</sup> the Court of Appeals of Georgia held that this provision enabled plaintiffs to recover from third parties who maliciously and intentionally procured a breach of fiduciary duty. This statutory cause of action is significantly more limited than the standard TPLFD claim, as it requires evidence of *malice* and *intent* rather than *knowledge*, and it only applies where the third party “procures an injury,” rather than “assists in a breach.”<sup>68</sup> At present, there appears to be no other state legislation that provides equivalent protection to that which plaintiffs typically enjoy under the common law TPLFD test.

Third parties who assist in breaches of fiduciary duty may also be held liable under federal statutes in some cases. For example, in *Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*,<sup>69</sup> the Supreme Court held that equitable relief could be awarded under § 502(a)(3) and (5) of ERISA against a third party who knowingly participates in a fiduciary’s breach. Another example is § 307 of the Private Securities Litigation Reform Act,<sup>70</sup> which imposes a positive duty on third parties who are attorneys to report “evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof.”<sup>71</sup> However, these state and federal laws are of very limited application and do not impose general liability on third parties who assist in a breach of fiduciary duty.

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66. GA. CODE ANN. § 51-12-30 (West 2000).

67. *Insight Tech., Inc. v. FreightCheck, LLC*, 633 S.E.2d 373, 379 (Ga. Ct. App. 2006).

68. See *infra* notes 69–70 and accompanying text.

69. *Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 248 (2000).

70. 15 U.S.C. § 7245 (2012).

71. *Id.*; Poonam Puri, *Taking Stock of Taking Stock*, 87 CORNELL L. REV. 99, 149–50 (2001).

*B. Tort of Interference with Contractual Relations*

The tort of interference with contractual relations may also be relevant.<sup>72</sup> Fiduciary duties may arise where there is a contractual relationship between the parties.<sup>73</sup> For example, in the Partnership Scenario, there may be a partnership agreement that imposes obligations on each partner.<sup>74</sup> Similarly, in the Trust Scenario, it is likely that there would be a trust deed that would impose contractual obligations on the trustee.<sup>75</sup> In situations where fiduciary duties overlap with contractual obligations, then either a contract or tort action will be available to the plaintiff.<sup>76</sup> For example, if the partnership agreement specifies that partners must act in the best interests of the partnership agreement, then the two defaulting partners in the Partnership Scenario may have breached both their fiduciary duty of loyalty and the partnership agreement by selling partnership assets without the third partner's approval.

Under the tort of interference with contractual relations or rights, plaintiffs must generally establish that: (1) a valid contract existed; (2) the third party knew of the contract; (3) the third party intentionally induced the contracting party to breach the contract; (4) the interference was "improper," "without justification," or otherwise "wrongful" in some way; (5) the contract was breached; (6) the breach was a proximate result of the defendant's conduct; and (7) the plaintiff suffered damages as a result.<sup>77</sup>

As a result, in those states that recognize the tort of interference with contractual relations, if a fiduciary commits breach of fiduciary duty and

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72. See *infra* note 77 and accompanying text.

73. See *Elm Ridge Exploration Co., LLC v. Engle*, 721 F.3d 1199, 1223 (10th Cir. 2013) ("[A]n action for breach of fiduciary duty which arises from contract can be based either in tort or [in] contract." (citation omitted)).

74. See *supra* text accompanying note 1.

75. See *supra* text accompanying note 1.

76. *Loehrke v. Wanta Builders, Inc.*, 445 N.W.2d 717, 720 (Wis. Ct. App. 1989) ("If, however, a tort duty coincides with a contract obligation, either a contract or a tort action will lie for its breach." (citation omitted)); *Pro-Pac, Inc. v. WOW Logistics Co.*, 721 F.3d 781, 786–87 (7th Cir. 2013).

77. See, e.g., *Warde v. Kaiser*, 887 F.2d 97, 101 (6th Cir. 1989) (citing *Dynamic Motel Mgmt., Inc. v. Erwin*, 528 S.W.2d 819, 822 (Tenn. App. 1975)); *Sirpal v. Fengrong Wang*, Civil No. WDQ-12-0365, 2012 WL 2880565, at \*3 (D. Md. July 12, 2012) (citing *K & K Mgmt., Inc. v. Lee*, 557 A.2d 965, 973 (Md. Ct. App. 1989)); *Beard Research, Inc. v. Kates*, 8 A.3d 573, 605 (Del. Ch. 2010), *aff'd sub nom.*, *ASDI, Inc. v. Beard Research, Inc.*, 11 A.3d 749 (Del. 2010) (citing *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 437 n.7 (Del. 2005)); *RESTATEMENT (SECOND) OF TORTS* § 766 (AM. LAW INST. 1977).

that breach is also a breach of contract, a beneficiary may be able to rely on that tort to obtain compensation from third party accessories.<sup>78</sup> For example, in *Rome Indus., Inc. v. Jonsson*,<sup>79</sup> a plaintiff corporation alleged that the corporation's president was induced by the defendants to breach his fiduciary duty to the corporation. While Georgia does not recognize a cause of action for participating in a breach of fiduciary duty, the Court of Appeals of Georgia held that because "[t]he fiduciary relationship between a corporation and its officer arises out of the contractual or employment relationship between the two parties,"<sup>80</sup> the tort of interference with contractual rights applied. As noted in Part I, it appears that most states that have not recognized third party liability for participating in breaches of fiduciary duty have recognized a tort of interference with contractual rights or relations.<sup>81</sup>

However, relying on this cause of action in the fiduciary context is unsatisfactory for two reasons. First, fiduciary duties may arise in the absence of a legally binding contract.<sup>82</sup> Further, even if there is a contract between the fiduciary and the beneficiary, a breach of a fiduciary duty may not result in a breach of contract. For example, while a director owes a fiduciary duty of loyalty to his company, this duty may not be incorporated into the director's employment contract. In fact, those beneficiaries who are most vulnerable to fiduciary wrongdoing, and therefore in the greatest need of protection, may not be sophisticated enough to have an agreement in place with the fiduciary that imposes these types of duties on the fiduciary.

Second, as noted above, the tort of interference with contractual relationships generally requires plaintiffs to prove that the third party interfered in the contract "intentionally" and with "malice." This standard will be significantly more difficult for plaintiffs to establish than "knowledge" required under the standard TPLFD test.<sup>83</sup> As discussed in Section C of Part IV below, there are good reasons for holding third parties who participate in breaches

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78. See, e.g., *Mack v. Am. Fletcher Nat'l Bank & Trust Co.*, 510 N.E.2d 725, 735–36 (Ind. Ct. App. 1987).

79. *Rome Indus., Inc. v. Jonsson*, 415 S.E.2d 651, 652 (Ga. Ct. App. 1992).

80. *Id.*

81. See *supra* Part I.

82. *Jachetta v. United States*, 653 F.3d 898, 905 (9th Cir. 2011) (citing *Shields v. Cape Fox Corp.*, 42 P.3d 1083, 1089–90 (Ala. 2002)) ("Under Alaska law, there are three possible sources of a fiduciary duty: (1) the fiduciary duty may be imposed by law independent of any contractual undertaking between the parties; (2) the fiduciary duty may be imposed by an explicit contractual promise; or (3) the fiduciary duty may be 'implied by law as a result of a contractual undertaking' between the parties."); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1224 (1995).

83. As noted in the Introduction, the third party must have "knowledge" of the breach in order to be held liable. See *supra* note 12 and accompanying text.

of fiduciary duties to a higher standard than third parties who participate in breaches of contract.<sup>84</sup>

### *C. Tort of Aiding and Abetting Fraud*

Where the alleged breach of fiduciary duty also involves some fraudulent conduct, beneficiaries may be able to rely on the tort of aiding and abetting fraud. Again, this cause of action has been recognized in a number of states.<sup>85</sup> In those states that recognize third party liability and aiding and abetting fraud, it is common to see both causes of action pleaded at the same time;<sup>86</sup> it appears that breach of fiduciary duty often involves some type of fraudulent conduct on the part of the fiduciary. However, because there are many breaches of fiduciary duty that do not involve fraudulent conduct, relying on this cause of action is unsatisfactory.

### *D. Civil Conspiracy and Concert of Action*

Another potentially relevant cause of action is civil conspiracy or concert of action claims. To establish civil conspiracy, there must generally be an agreement between two or more persons to participate in an unlawful act, or a lawful act in an unlawful manner, and damages caused by one or more unlawful overt acts of one of the parties to the agreement.<sup>87</sup> Concert of action claims are similar.<sup>88</sup> The key distinction between civil conspiracy or concert of action claims to participate in a breach of fiduciary duty and

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84. See *infra* Part IV.C.

85. See, e.g., *River Colony Estates Gen. P'ship v. Bayview Fin. Trading Grp., Inc.*, 287 F. Supp. 2d 1213 (S.D. Cal. 2003).

86. See, e.g., *In re Syntax-Brilliant Corp.*, 573 F. App'x 154, 155 (3d Cir. 2014); *Krys v. Pigott*, 749 F.3d 117, 121 (2d Cir. 2014).

87. See, e.g., *Halberstam v. Welch*, 705 F.2d 472, 477 (D.C. Cir. 1983); *Pye v. Estate of Fox* 633 S.E.2d 505, 511 (S.C. 2006) (citation omitted); *Mackey v. Mackey*, 914 S.W.2d 48, 50 (Mo. Ct. App. 1996) (citing *Garrity v. A.I. Processors*, 850 S.W.2d 413, 418 (Mo. Ct. App. 1993)).

88. For a discussion on concert of action, see *Dow Chem. Co. v. Mahlum*, 970 P.2d 98, 112 (Nev. 1998) ("Concert of action resembles the tort of civil conspiracy. . . . Civil conspiracy in Nevada differs from concert of action as defined in Section 876 in that civil conspiracy requires that the defendants have an intent to accomplish an unlawful objective for the purpose of harming another, while concert of action merely requires that the defendants commit a tort while acting in concert. Both causes of action require an agreement."); RESTATEMENT (SECOND) OF TORTS § 876(a) (AM. LAW INST. 1979) ("For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with him . . . .").

TPLFD is that conspiracy and concert of action claims require an *agreement* or *common purpose* between the fiduciary and the third party to participate in a wrongful activity.<sup>89</sup> As the United States Court of Appeals for the Sixth Circuit has noted:

[T]he degree of involvement required for civil conspiracy is higher than that for civil aiding and abetting. Whereas “[a]iding-abetting focuses on whether a defendant knowingly gave ‘substantial assistance’ to someone who performed wrongful conduct,” conspiracy focuses “on whether the defendant *agreed to join in* the wrongful conduct.”<sup>90</sup>

The causation requirements,<sup>91</sup> and available remedies, may also differ.<sup>92</sup> Accordingly, third parties who knowingly provide substantial assistance

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89. See, e.g., *Halberstam*, 705 F.2d at 478; *Wells Fargo Bank v. Ariz. Laborers, Teamsters & Cement Masons Local No. 395 Pension Tr. Fund*, 38 P.3d 12, 37 (Ariz. 2002) (“... a claim for civil conspiracy must include an actual agreement, proven by clear and convincing evidence . . . .”); *Aetna Cas. & Sur. Co. v. Leahey Const. Co.*, 219 F.3d 519, 534 (6th Cir. 2000) (“... the following elements must be proven [in order to establish a claim of civil conspiracy]: ‘(1) a malicious combination; (2) two or more persons; (3) injury to person or property; and (4) existence of an unlawful act independent from the actual conspiracy.’” (quoting *Universal Coach, Inc. v. New York City Transit Auth., Inc.*, 629 N.E.2d 28, 33 (Ohio Ct. App. 1993))). For an example of a case where the court found a third party had aided and abetted fraudulent conduct but had not engaged in a civil conspiracy, see *Aetna Cas. & Sur. Co.*, 219 F.3d at 538–39 (“Although it was reasonable for the jury to infer, based on the circumstantial evidence presented by Travelers, that Donnelly knew that Leahey was engaging in tortious conduct, it was unreasonable for the jury to further infer that Leahey ‘agreed to join in’ his scheme.”); *Dow Chem. Co.*, 970 P.2d at 112 (“Concert of action resembles the tort of civil conspiracy. . . . Both causes of action require an agreement.”). But cf. *El Camino Res., Ltd. v. Huntington Nat’l Bank*, 722 F. Supp. 2d 875, 900–01 (W.D. Mich. 2010), *aff’d*, 712 F.3d 917 (6th Cir. 2013) (“Liability under a civil conspiracy theory is based upon the defendant’s adoption of the common purpose or design by agreement, either express or implied. In a concert of action theory, liability is premised upon not agreement, but action in furtherance of a common purpose. . . . In either case, the defendant’s embrace of the actor’s purpose or design—whether by agreement or by action—renders the defendant liable for the underlying tort.”).

90. *Aetna Cas. & Sur. Co.*, 219 F.3d at 538 (citing *Halberstam*, 705 F.2d at 478); see also *Am. Master Lease LLC v. Idanta Partners*, No. B244689, 2014 WL 715876, at \*12–13 (Cal. Ct. App. Feb. 25, 2014).

91. *Am. Master Lease*, 2014 WL 715876, at \*13 (“Additionally, causation is an essential element of an aiding and abetting claim, i.e., plaintiff must show that the aider and abettor provided assistance that was a substantial factor in causing the harm suffered. . . . This difference too demonstrates the distinction between the forms of liability. . . .” (citations omitted)).

92. *Halberstam*, 705 F.2d at 478 (D.C. Cir. 1983) (“The theory of liability also affects who is liable for what. An aider-abettor is liable for damages caused by the main perpetrator, but that perpetrator, absent a finding of conspiracy, is not liable for the damages caused by the aider-abettor.”). This distinction can be explained by *Neilson v. Union Bank of Cal.*, 290 F. Supp. 2d 1101, 1134–35 (C.D. Cal. 2003) (“Unlike a conspirator, an aider and abettor does not ‘adopt as his or her own’ the tort of the primary violator. Rather, the act of aiding and abetting is distinct from the primary violation; liability attaches because the aider and abettor behaves in a manner that enables the primary violator to

to a defaulting fiduciary, but do not have an *agreement* or share a *common purpose* with the fiduciary, will not be held liable. For example, in the Trust Scenario, while the accountant provided substantial assistance in siphoning the trust funds from a trust, the plaintiff may have difficulty proving that the accountant and the defaulting trustee had jointly agreed to steal the trust funds. Again, these torts are not recognized in all jurisdictions.<sup>93</sup>

#### *E. Criminal Aiding and Abetting Liability*

To the extent that the breach of fiduciary duty involves criminal conduct, the third party may be liable under criminal aiding and abetting liability. However, many breaches of fiduciary duty will not involve any criminal activity. For example, the Partnership Scenario may not involve any criminal conduct.

#### *F. Primary Liability*

In some cases, the third party may have engaged in conduct that is wrongful in its own right as part of assisting in a breach of fiduciary duty. For example, if the third party has forged documents as part of providing the assistance, the third party may be primarily liable for fraud. If the third party's assistance involves misappropriating property from the beneficiary, the third party may be liable for theft.

#### *G. Trust Law*

States that do not recognize third party liability for participating in breaches of fiduciary duty may generally still impose liability on third parties who obtain benefits in breach of *trust*. For example, the U.S. Supreme Court has noted that:

[I]t has long been settled that when a trustee in breach of his fiduciary duty to the beneficiaries transfers trust property to a third person, the third person takes the property subject to the trust, unless he has purchased the property for value and

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commit the underlying tort. . . . Because aiders and abettors do not agree to commit, and are not held liable as joint tortfeasors for committing, the underlying tort, it is not necessary that they owe plaintiff the same duty as the primary violator. Conspirators, by contrast, are held liable for the tort committed by their co-conspirator.”).

93. See, e.g., *MBF Clearing Corp. v. Shine*, 623 N.Y.S.2d 204, 205 (N.Y. App. Div. 1995) (“New York does not recognize a substantive tort of conspiracy . . .” (citing *Routsis v. Swanson*, 270 N.Y.S.2d 908 (N.Y. App. Div. 1966))).



without notice of the fiduciary's breach of duty. The trustee or beneficiaries may then maintain an action for restitution of the property (if not already disposed of) or disgorgement of proceeds (if already disposed of), and disgorgement of the third person's profits derived therefrom.<sup>94</sup>

Another example is found in the Georgia Code. While the Code does not impose liability on third parties, it enables beneficiaries to trace misapplied trust assets into "the hands of persons affected with notice of the misapplication."<sup>95</sup> As a result, in some jurisdictions beneficiaries of trusts may have additional protection that is not offered to beneficiaries in other fiduciary relationships. However, the large number of fiduciary relationships that are not trustee–beneficiary relationships will not be covered by these laws.

#### *H. Restitution, Unjust Enrichment, and Constructive Trusts*

In states that do not recognize TPLFD, it is possible that principles of restitution, unjust enrichment, and constructive trusts may enable beneficiaries to recover benefits that third parties have obtained as a result of a fiduciary's breach. For example, the Restatement (Third) of Restitution and Unjust Enrichment states that if property is "transferred in breach of the transferor's fiduciary duty, the beneficiary may obtain restitution from any subsequent transferee who does not qualify as a bona fide purchaser,"<sup>96</sup> and that where

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94. *Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 250 (2000). For example, in Indiana "all persons participating [in a breach of trust] are liable to the beneficiaries as principals, and may be compelled to make good to the trust estate the resulting loss." *State v. Citizens' Nat'l Bank*, 170 N.E. 346, 351 (Ind. App. 1930); *see, e.g., Bank of Giles Cty. v. Fid. & Deposit Co. of Md.*, 84 F.2d 321, 324 (4th Cir. 1936) ("It is well established that one who participates in a breach of trust may be held liable in a court of equity either to account for the trust property or its proceeds if still in his possession or to respond in damages if he has parted with them."); *Blankenship v. Boyle*, 329 F. Supp. 1089, 1099 (D.D.C. 1971) ("The civil wrong here is a breach of trust; and it is settled that where a third person 'has knowingly assisted the trustee in committing a breach of trust, he is liable for participation in the breach of trust.'" (quoting 4 SCOTT ON TRUSTS § 326 (3d ed. 1967))). The Uniform Trust Code, which has been adopted in at least twenty-five states, limits the liability of third parties in these situations. It provides that third parties will not be liable if they in good faith assist a trustee without knowledge that the trustee is breaching its duties. UNIF. TRUST CODE § 1012(a) (UNIF. LAW COMM'N 2000).

95. GA. CODE ANN. § 53-12-301(b) (2015).

96. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmt. g (AM. LAW INST. 2011); *see also Harris Trust*, 530 U.S. at 250 ("... it has long been settled that when a trustee in breach of his fiduciary duty to the beneficiaries transfers trust property to a third person, the third person takes the property subject to the trust, unless he has purchased the property for value and without notice of the fiduciary's breach of duty. The trustee or beneficiaries may then maintain an action for restitution of the property (if not already disposed of) or disgorgement of proceeds (if already disposed of), and disgorgement of the third person's profits derived therefrom."); *Beatty v. Guggenheim*

the subsequent transferee “acquires a benefit with notice of the fiduciary’s breach of duty,” then they will be required “to disgorge profits (including consequential gains).”<sup>97</sup> Similarly, “[i]t is well settled that a constructive trust may be imposed upon property in the hands of a third party if the third party is not a bona fide purchaser.”<sup>98</sup> Under these principles, benefits received by third parties in breach of a fiduciary duty may be recoverable by beneficiaries.<sup>99</sup> However, it is not clear whether the states that have not recognized TPLFD would apply these principles to enable such recovery.<sup>100</sup> In addition, these doctrines would only apply where the breach of fiduciary duty involved some transfer of property or other benefit to the third

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Expl. Co., 122 N.E. 378, 380 (N.Y. 1919) (“A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.”); RESTATEMENT (SECOND) OF TRUSTS § 284 (AM. LAW INST. 1959) (“If the trustee in breach of trust transfers trust property to, or creates a legal interest in the subject matter of the trust in, a person who takes for value and without notice of the breach of trust, and who is not knowingly taking part in an illegal transaction, the latter holds the interest so transferred or created free of the trust, and is under no liability to the beneficiary.”).

97. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmt. h (AM. LAW. INST. 2011).

98. *Forbes v. Wells Beach Casino, Inc.*, 409 A.2d 646, 653 (Me. 1979) (first citing 5 SCOTT ON TRUSTS, § 469 (3d ed. 1967); and then *Wilson v. Mason*, 5 U.S. (1 Cranch) 45 (1801)). However, other cases suggest that additional elements may need to be established. *See, e.g., United States v. Inc. Vill. of Island Park*, 888 F. Supp. 419, 456 (E.D.N.Y. 1995) (citations omitted) (“The elements of a constructive trust under New York law are (1) a confidential or fiduciary relationship; (2) a promise, express or implied; (3) a transfer made in reliance on that promise; and (4) unjust enrichment. . . . However, because of its equitable nature, a constructive trust has been imposed in cases where not all of those elements are present.”).

99. *Taylor v. Maile*, 127 P.3d 156, 163–64 (Idaho 2005) (“This Court has recognized a trust beneficiary’s right to pursue redress where trust property has wrongfully made its way into the hands of a third party. . . . In *Fenton v. King Hill Irr. Dist.*, . . . 186 P.2d 477, 483 (1947), the Court said ‘Where a fiduciary wrongfully transfers to a third person property which he holds as fiduciary, the third person is chargeable as constructive trustee of the property unless he is a bona fide purchaser.’”).

100. For an illustration of how differently various States treat unjust enrichment claims, see for example, *Sheet Metal Workers Local 441 Health & Welfare Plan v. GlaxoSmithKline, PLC*, 737 F. Supp. 2d 380, 429–48 (E.D. Pa. 2010); *see also Harvell v. Goodyear Tire & Rubber Co.*, 164 P.3d 1028, 1036 (Okla. 2006) (“The elements of unjust enrichment claims differ markedly from state to state. In addition to the differences in these basic criteria, state considerations of such claims differ over issues of misconduct, availability of adequate remedies at law, and the effect of the existence of an express contract governing the transaction.”).

party.<sup>101</sup> As a result, beneficiaries who have suffered a loss as a result of a fiduciary breach will not have any rights to obtain compensation for that loss from third parties who assisted in the breach without obtaining property or similar benefit.

### *I. Professional Rules*

Where the third party is a professional, professional conduct rules may act as a deterrent to participating in breaches of fiduciary duty. For example, the ABA Model Rules of Professional Conduct state that lawyers must ordinarily decline to act for clients “if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law”<sup>102</sup> and that it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.<sup>103</sup> Similarly, accountants have a professional code of conduct that holds them to certain ethical standards.<sup>104</sup> However, relying on professional rules has the obvious drawback of only applying to professionals—and not other types of third parties who could potentially assist in a breach of trust, such as corporations or individuals who are not professionals—and not providing any cause of action by which plaintiffs can seek compensation. Accordingly, these rules will only have a deterrent effect in relation to a limited number of potential third party wrongdoers.

### *J. Conclusion*

While it is beyond the scope of this Article to undertake an in-depth analysis of the potential alternative causes of action that may apply in each state that has not recognized TPLFD, the discussion above has highlighted common alternatives and some of their limitations. For example, under

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101. *Flanigan v. Munson*, 818 A.2d 1275, 1281 (N.J. 2003) (“... our courts employ a two-prong test when determining whether a constructive trust is warranted in a given case. First, a court must find that a party has committed ‘a wrongful act.’... Second, the wrongful act must result in a transfer or diversion of property that unjustly enriches the recipient.” (citations omitted)).

102. MODEL RULES OF PROF’L CONDUCT r. 1.16 cmt. (AM. BAR ASS’N 2005), [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_1\\_16\\_declining\\_or\\_terminating\\_representation/comment\\_on\\_rule\\_1\\_16\\_declining\\_or\\_terminating\\_representation.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_16_declining_or_terminating_representation/comment_on_rule_1_16_declining_or_terminating_representation.html) [https://perma.cc/8FCA-9WVL].

103. MODEL RULES OF PROF’L CONDUCT r. 8.4 (AM. BAR ASS’N 2005), [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_8\\_4\\_misconduct.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_8_4_misconduct.html) [https://perma.cc/3ZQZ-8FJT].

104. *AICPA Code of Professional Conduct*, AICPA, <http://www.aicpa.org/RESEARCH/STANDARDS/CODEOFCONDUCT/Pages/default.aspx> [https://perma.cc/27VY-WWAH] (last visited July 30, 2016).

the Partnership Scenario, unless it could be shown that the defaulting partners had breached a particular term of the partnership agreement or that the two partners or the bank engaged in some type of fraudulent or criminal conduct, it is likely to be difficult for the other partners to hold the bank liable for his actions. However, before adopting TPLFD as a new cause of action in a state, it would be worthwhile to analyze that state's existing laws to ensure that it is necessary. If existing causes of action are sufficient, the creation of a new overlapping cause of action would be unjustified.

### III. HOW SHOULD TPLFD BE RECOGNIZED?

Parts I and II established convincing reasons for holding third parties liable for participating in breaches of fiduciary duty, and demonstrated that other existing causes of action may not provide sufficient protection to beneficiaries. The question then becomes: In those states that do not currently recognize this form of liability and do not have existing laws that provide sufficient protection, how should TPLFD be adopted?

#### A. *Declare It is the Law*

The Supreme Court of Nevada recently adopted TPLFD without providing any principled reasons why it should do so. The court simply stated, “[a]lthough we have not previously recognized a claim for aiding and abetting the breach of a fiduciary duty, we take this opportunity to do so.”<sup>105</sup> Without any explanation, it adopted the test applied by Delaware courts to establish liability. Recognizing a new cause of action in this manner is unsatisfactory, as it exposes the court to claims of illegitimate judicial law-making. Arguably, it breaches the separation of powers set out in most state constitutions, which typically vest legislative power in the state legislature.<sup>106</sup> “Judges ought to remember that their office is *jus dicere*, and not *jus dare*; to interpret law, and not to make law, or give

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105. *In re Amerco Derivative Litig.*, 252 P.3d 681, 701–02 (Nev. 2011).

106. *See, e.g.*, NEV. CONST. of 1864, art. IV, § 1 (“The Legislative authority of this State shall be vested in a Senate and Assembly which shall be designated ‘The Legislature of the State of Nevada’ . . .”).

law . . .”<sup>107</sup> and that “the creation of new rights ought to be left to legislatures, not courts.”<sup>108</sup>

### *B. Adopt from Other States*

An alternative to declaring the existence of TPLFD without explanation is for the courts to expressly justify its introduction into the state on the basis that it has been adopted in other U.S. jurisdictions.<sup>109</sup> Giving regard to other jurisdictions’ authorities has been recognized by some courts as a legitimate approach to judicial decision-making.<sup>110</sup> For example, the Indiana Court of Appeal has stated, “where no Indiana cases adequately address the issues involved in a case, decisions of other jurisdictions may be instructive,”<sup>111</sup> and the Supreme Court of Alabama has noted that decisions of other states “may be considered if it appears to throw light on the question in issue, but it will be followed by the court in the sister state only if the reasoning of the decision is persuasive.”<sup>112</sup> Adopting third party liability based on the cause of action that has been applied by one of the states for some time, such as New York or Delaware, would give the adopting state the benefit of the established body of case law on it. However, it still gives rise to serious concerns that the courts are adopting a legislative function.

### *C. Reason by Analogy*

A more principled approach is for state courts to determine that there is a cause of action for TPLFD based on analogy to other similar claims recognized in the relevant state. While Judge Posner described reasoning by analogy as “a method of cautious, incremental judicial legislating,”<sup>113</sup> it is one that has more legitimacy than simply declaring the law or adopting the laws of another state.<sup>114</sup>

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107. Grant v. State, 336 S.E.2d 354, 355 (Ga. App. 1985) (citing FRANCIS BACON, OF JUDICATURE, reprinted in AMERICAN JUDICATURE SOCIETY, HANDBOOK FOR JUDGES 276 (Glenn R. Winters, ed. 1975)).

108. Musick, Peeler & Garrett v. Emp’rs. Ins., 508 U.S. 286, 291 (1993).

109. See *infra* notes 111–12 and accompanying text.

110. See *infra* notes 111–12 and accompanying text.

111. Blakley Corp. v. EFCO Corp., 853 N.E.2d 998, 1004 (Ind. Ct. App. 2006).

112. Fox v. Hunt, 619 So. 2d 1364, 1367 (Ala. 1993) (citing 20 AM. JUR. 2d Courts § 203 (1965)); see also Conn. Carpenters Benefit Funds v. Burkhard Hotel Partners II, 849 A.2d 922, 926 (Conn. App. 2004) (“In the absence of state decisional guidance, we look to the reasoning of other jurisdictions that have confronted analogous circumstances.”).

113. Richard A. Posner, *Reasoning by Analogy*, 91 CORNELL L. REV. 761, 773–74 (2006).

114. See, e.g., Emily Sherwin, *A Defense of Analogical Reasoning in Law*, 66 U. CHI. L. REV. 1179, 1197 (1999).

However, when reasoning by analogy, courts should take care to ensure that the original cause of action is in fact analogous. As Sunstein notes, “analogical reasoning can go wrong . . . when some similarities between two cases are deemed decisive with insufficient investigation of relevant differences.”<sup>115</sup> For example, in *Continental Casualty Co. v. Compass Bank*, a U.S. District Court rejected the plaintiff’s argument that Alabama should recognize a cause of action for aiding and abetting a breach of fiduciary duty because it was analogous to a claim for aiding and abetting fraud that the plaintiff argued had been recognized by the Alabama courts.<sup>116</sup> The court stated that the two causes of action were not “analogous” because “[a]iding and abetting a fraud does not “represent the same interest and address the same harms” as aiding and abetting a breach of fiduciary duty.”<sup>117</sup>

The case of *Deer Creek Fabrics, Inc. v. Colyer* demonstrates the dangers of reasoning by analogy.<sup>118</sup> In this case, a Connecticut Superior Court considered a plaintiff’s claim for “tortious interference with fiduciary relations.”<sup>119</sup> The court appeared to be unaware of existing precedent in Connecticut that had already established a standard TPLFD test for liability,<sup>120</sup> and instead developed the test having regard to “analogous torts.” The court examined the tort of interference with business expectancies<sup>121</sup> and tortious interference with contractual relations, both of which require plaintiffs to establish that the third party interfered in the business expectancy or contractual relationship with intent and with knowledge of the relationship. Reasoning by analogy, the court determined that in order

115. Cass R. Sunstein, *On Analogical Reasoning*, 106 HARV. L. REV. 741, 757 (1992–1993).

116. *Cont’l Cas. Co. v. Compass Bank*, No. Civ. A. 04-0766-KD-C, 2006 WL 566900, at \*12 (S.D. Ala. Mar. 6, 2006).

117. *Id.* (citing *Allison v. Vintage Sports Plaques*, 136 F.3d 1443, 1447 (11th Cir. 1998)).

118. *Deer Creek Fabrics, Inc. v. Colyer*, No. X05CV054002792S, 2007 WL 865697 (Conn. Super. Ct. Mar. 2, 2007).

119. *Id.* at \*4.

120. *See id.*; *see also, e.g.*, *Stanley Ferber & Assocs. v. Ne. Bancorp., Inc.*, No. CV 93-0344932, 1993 WL 489334 (Conn. Super. Ct. Nov. 16, 1993) (stating that the elements of aiding and abetting breach of fiduciary duty are “1) a breach of duty by the party who does owe them a fiduciary duty; 2) knowledge by the aider that the fiduciary is breaching a duty, and 3) provision by the alleged aider of substantial assistance in the wrongdoing by the fiduciary.”).

121. *See Deer Creek Fabrics*, 2007 WL 865697, at \*4. This tort requires the plaintiff to establish that the third party intentionally and maliciously interfered with the business relationship while knowing of the relationship. *See id.*

to establish a claim for aiding and abetting a breach of fiduciary duty, the plaintiff must show that the third party intentionally facilitated, assisted in, or participated in the breach and intended to cause harm to the plaintiff.<sup>122</sup> Because this test required proof of *intent* to harm, rather than knowledge of wrongdoing,<sup>123</sup> it is significantly more difficult for plaintiffs to establish than the standard TPLFD test adopted in other jurisdictions.

In *Deer Creek*, the court failed to acknowledge the key differences between contractual and fiduciary duties that may justify holding third parties who participate in a breach of fiduciary duty to a higher standard than third parties who participate in a breach of a contract.<sup>124</sup> First, contract and fiduciary law are founded on different assumptions. Contract law is based on the assumption that contracting parties have equal bargaining power and act in their own best interests.<sup>125</sup> In contrast, fiduciary law assumes that there is an imbalance in power and that the beneficiary is vulnerable.<sup>126</sup> Second, the two areas of law have different purposes and applications.<sup>127</sup> The purpose of fiduciary law is to reduce risks to beneficiaries; therefore, it predominately regulates fiduciaries—it imposes fiduciary duties on fiduciaries, not beneficiaries.<sup>128</sup> In contrast, the purpose of contract law is to formalize and enforce mutual promises; therefore, it regulates both parties equally.<sup>129</sup> Third, there is arguably a moral dimension to fiduciary duties arising out of the imbalance of power and the vulnerability of the beneficiary, and the trust and confidence beneficiaries typically have in fiduciaries that do not exist in the contractual context.<sup>130</sup> For these reasons, reliance on the analogy

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122. *See id.*

123. *See id.*

124. *See* Scott Fitz Gibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 303 (1999).

125. *See* Frankel, *supra* note 82, at 1225–26.

126. *See id.*

127. *See id.*

128. *See id.*

129. *See id.*

130. *See id.* In addition to the key differences between fiduciary duties and contractual duties noted above, many others exist. For example, the fiduciary consents to serve without the need for consent by the beneficiary, whereas contract law requires the consent of both parties; fiduciary law imposes more prescriptive duties on fiduciaries than contract law imposes on contracting parties; and remedies for breach of fiduciary duty are calculated differently to contractual damages. *Id.* It is also more difficult to contract out of fiduciary duties than other implied contractual “default rules.” Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 888 (1988). Further, there are some features of particular fiduciary relationships, such as the trust, that cannot be created using contractual drafting, such as the ability of trusts to protect the trustee from creditors of the trust, and protect the assets of the trust from the creditors of the trustee and settlor. Lee-Ford Tritt, *The Limitations of an Economic Agency Cost Theory of Trust Law*, 32 CARDOZO L. REV. 2579, 2600 (2011).

with interference with contractual relations to establish the TPLFD test was flawed.

#### *D. Reason by Induction*

“Induction is, generally, the process of taking a number of specific cases or instances, classifying them into categories according to relevant attributes and outcomes, and generalizing an inclusory rule from them.”<sup>131</sup>

In states that have recognized liability for third parties who “aid and abet” or assist in other torts, it may be open for the courts to find a general rule of third party liability for participating in torts—which would include breach of fiduciary duty—by a process of reasoning by induction. This type of general rule is reflected in section 876(b) of Restatement (Second) of Torts, which states that third parties who know that a primary wrongdoer is engaging in tortious conduct and “gives substantial assistance or encouragement to the other so to conduct himself,” will be liable for harm resulting to persons harmed by that conduct.<sup>132</sup> For example, the Missouri Court of Appeal recently held that because section 876(b) had “been expressly recognized as a cause of action in Missouri,” in relation to other physical torts, there was a cause of action for “a claim for aiding and abetting a breach of fiduciary duties.”<sup>133</sup> Similarly, in *Television Events & Mktg., Inc. v. Amcon Distrib. Co.*,<sup>134</sup> a U.S. District Court held that because the Hawaii Supreme Court had recognized and applied section 876 in another case relating to battery, “a third party’s interference with one’s fiduciary duty to another is actionable under Hawaii law.” However, like the other forms of judicial reasoning noted above, there are concerns regarding whether it is legitimate for the courts to engage in reasoning by induction to significantly expand the application of existing principles. There is also

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131. Dan Hunter, *Reason Is Too Large: Analogy and Precedent in Law*, 50 EMORY L.J. 1197, 1207 (2001).

132. RESTATEMENT (SECOND) OF TORTS § 876(b) (AM. LAW INST. 1979).

133. Nickell v. Shanahan, No. ED99163, 2013 WL 2402852, at \*8 (Mo. Ct. App. June 4, 2013). In response to the defendant’s argument that § 876(b) had only been applied in relation to physical torts and should not be expanded further, the court stated

[w]e see no reason why the recognized tort for aiding and abetting should apply exclusively to claims alleging a defendant aided and abetted an underlying physical tort such as negligence, assault, or battery, but not apply when the underlying tort that is being aided and abetted is a breach of fiduciary duties.

*Id.*

134. *Television Events & Mktg., Inc. v. Amcon Distrib. Co.*, 488 F. Supp. 2d 1071, 1075–78 (D. Haw. 2006).



a concern that this approach may fail to give sufficient weight to the differences between the underlying primary wrongs third party liability is seeking to protect. As discussed under Section C above, in the context of third party liability for inducing breach of contract, differences between primary wrongs may justify holding third parties who participate in those wrongs to different standards.<sup>135</sup>

#### *E. Enact Legislation*

The final option is for states to enact legislation that recognizes TPLFD. This would be the most preferable outcome, as it would avoid any allegations of illegitimate judge-made law and would also avoid the risks associated with reasoning by analogy and induction highlighted above. In addition, it would give legislators the opportunity to set out a clear test for establishing TPLFD, which would enable them to address many of the uncertainties that surround the common law test for liability in states where it has been recognized. Legislators will also be able to take advantage of one of the benefits of federalism, by drawing on the best approaches from other states.<sup>136</sup> Some possible approaches are suggested in Part IV.<sup>137</sup>

### IV. THIRD PARTY LIABILITY: ELEMENTS AND ISSUES

Parts I to III argued that TPLFD should be adopted—preferably by legislation—in those states that have not yet recognized it, unless there are existing causes of action that sufficiently protect beneficiaries.<sup>138</sup> While it is beyond the scope of this Article to provide detailed guidance on the form of TPLFD that should be adopted, this Part will set out some key issues for courts or legislators to consider. Some of these issues have been the subject of academic and judicial commentary, such as knowledge, assistance, and privileges.<sup>139</sup> The remaining issues have largely been ignored by academics: whether a distinction should be made between trustees and other types of fiduciaries, and the remedies available to beneficiaries under TPLFD.

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135. See *supra* Part II, Section C.

136. Jonathan H. Adler, *Interstate Competition and the Race to the Top*, 35 HARV. J.L. & PUB. POL'Y 89, 95 (2012).

137. See *infra* Part IV.

138. See *supra* Parts I–III.

139. See *Perlman v. Wells Fargo Bank*, 830 F. Supp. 2d 1308, 1321 (S.D. Fla. 2011).

*A. Knowledge*

The requirement that the third party have *knowledge* of the fiduciary breach in order to be held liable under TPLFD has been described as “the crux of aiding and abetting liability.” The knowledge element raises two key questions.

As an initial matter, what does the third party need to know? Courts have suggested different formulas for this element, ranging from knowledge that:

- (a) an independent wrong is being committed by the primary wrongdoer;<sup>140</sup>
- (b) the third party is “generally aware of his role in the overall wrongful activity”;<sup>141</sup> to
- (c) the fiduciary’s conduct contravenes a fiduciary duty.<sup>142</sup>

If a third party is aware that they are assisting in some kind of wrongful conduct, there does not appear to be any persuasive reason for not holding them liable—even if they are not specifically aware it is a breach of *fiduciary duty*. The question of whether a breach of fiduciary duty has occurred is a technical legal question, which only the most sophisticated third parties are likely to be able to answer accurately. Holding third parties liable in each of (a) through (c) above would have the desired deterrent and compensatory effect discussed in Part I, and would also attach liability to “morally blameworthy” conduct. Accordingly, each of (a) and (b) above should be sufficient to give rise to liability.

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140. In *Woodward v. Metro Bank of Dall.*, 522 F.2d 84, 95 (5th Cir. 1975), the court criticized this approach in the context of third party liability for securities fraud, stating that it posed “a danger of over-inclusiveness and seem to lose sight of the necessary connection to the securities laws. One could know of the existence of a ‘wrong’ without being aware of his role in the scheme, and it is the participation that is at issue.”

141. *In re Temporomandibular Joint (TMJ) Implants Prods. Liab. Litig.*, 113 F.3d 1484, 1495 (8th Cir.1997); *see also* Nat’l R.R. Passenger Corp. v. Veolia Transp. Servs., Inc., 592 F. Supp. 2d 86, 96 (D.D.C. 2009) (“A general awareness of wrongdoing on the part of the one being aided or abetted is sufficient to show knowledge on the part of an aider and abettor.”); *cf.* *El Camino Res., Ltd. v. Huntington Nat’l Bank*, 722 F. Supp. 2d 875, 909–10 (W.D. Mich. 2010), *aff’d*, 712 F.3d 917 (6th Cir. 2013).

142. *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 282–83 (2d Cir. 1992) (“The relevant ‘knowledge’ for liability to attach for knowingly participating in a fiduciary’s breach of duty is knowledge as to the primary violator’s status as a fiduciary and knowledge that the primary’s conduct contravenes a fiduciary duty.”); *see also* *Chem-Age Indus., Inc. v. Glover*, 652 N.W.2d 756, 775 (S.D. 2002).

The next question that arises is what level of knowledge is required to give rise to liability? Is actual knowledge required—in which case, does it include actual knowledge inferred from the circumstances?<sup>143</sup> Or is constructive knowledge sufficient—such as knowledge inferred from willful blindness, recklessness,<sup>144</sup> or carelessness?

Courts and commentators have tended to favor a relatively narrow test, requiring plaintiffs to establish that third parties had actual knowledge that the fiduciary's conduct was a breach of fiduciary duty.<sup>145</sup> This approach appears to have been driven by underlying policy concerns that a broad test for TPLFD may have undesirable consequences for third parties that may impact on potential beneficiaries. These concerns were discussed in Part I.

However, limiting the TPLFD test to actual knowledge of a fiduciary's breach would allow third parties who strongly suspected that they were assisting in a breach of fiduciary duty to “shut their eyes” to escape liability. This would undermine the deterrent effect of the liability, reducing TPLFD's ability to protect fiduciary relationships.<sup>146</sup> Further, plaintiffs would face

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143. *Allou Distribs. Inc. v. United Talmudical Acad. Torah (In re Allou Distribs., Inc.)*, 446 B.R. 32, 51–52 (Bankr. E.D.N.Y. 2011) (“To be sure, a defendant's admission of actual knowledge of the underlying fraud is likely to be rare. But such direct evidence of actual knowledge is not necessary to establish this element of the claim. Rather, actual knowledge may be inferred from circumstantial evidence, provided that the central inquiry remains whether the evidence permits a reasonable finder of fact to infer that the defendant *actually knew* of the underlying fraud.”).

144. *See, e.g., Design Strategies, Inc. v. Davis*, No. 02 CIV. 5329 (VM), 2004 WL 1394327 (S.D.N.Y. June 22, 2004) (“In some circumstances, even if it can be established that the aider/abettor did not know of the primary breach, ‘a third party can become obligated to investigate an agent's actions where there are indications that the agent's actions are suspicious in nature. A failure to investigate under such circumstances may result in the third party's liability for aiding and abetting the agent's breach of his fiduciary duty.’ . . . In these cases, there may be sufficient ‘red flags’ to create an issue of material fact as to whether the accused aider and abettor should have known of the breach.” (citation omitted)); *E.S. Bankest, L.C. v. BDO Seidman, LLP (In re E.S. Bankest, L.C.)*, Case No. 04-17602-BKC-AJC, Adv. No. 06-1220-BKC-AJC-A, 2010 WL 1417732, at \*1 (Bankr. S.D. Fla. Apr. 6, 2010) (“BDO argues that the undisputed record precludes a finding of scienter on Plaintiff's securities fraud claim and the knowledge element of its aiding and abetting breach of fiduciary duty claims. Both the scienter and knowledge elements are satisfied by a showing of recklessness.”).

145. *See, e.g., Kolbeck v. LIT Am., Inc.*, 939 F. Supp. 240, 246 (S.D.N.Y. 1996), *aff'd*, 152 F.3d 918 (2d Cir. 1998) (noting that “actual knowledge is necessary to impose liability for participating in a breach of fiduciary duty” in New York and that similar approaches have been taken in California and Missouri); *Terrydale Liquidating Tr. v. Barness*, 611 F. Supp. 1006, 1027 (S.D.N.Y. 1984) (“Actual knowledge of a breach of duty is required; mere suspicion or even recklessness as to the existence of a breach is insufficient.”).

146. Josephine T. Willis, *To (b) or Not to (b): The Future of Aider and Abettor Liability in South Carolina*, 51 S.C. L. REV. 387, 396 (2000).

significant difficulties in proving “actual knowledge,” as it requires proof of the subjective state of mind of a defendant. Expanding the test to actual knowledge inferred from the circumstances and willful blindness would enable the court to fill the gaps where there are strong facts suggesting that the defendant had actual knowledge, even though subject knowledge itself cannot be established.<sup>147</sup> While this expansion would increase costs to third parties, it would only do so in limited circumstances—where they are put on strong notice that something is suspicious—where it is more likely that wrongdoing is actually occurring.<sup>148</sup> If another purpose of TPLFD is to deter or punish wrongful or unconscionable conduct by third parties, this would support holding third parties liable where they are “willfully blind” to a breach.

If there are particular types of fiduciary relationships that policy makers believe require additional protection from third parties, then the relevant government could enact legislation to address those particular concerns, such as by imposing a “duty to inquire” on specific types of third parties in certain circumstances. For example, in response to concerns about wrongdoing in the securities sector, attorneys must now report “evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof” under section 307 of the Private Securities Litigation Reform Act.<sup>149</sup> Another example is the trustee—

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147. However, note the concerns expressed in *El Camino Resources, Ltd. v. Huntington National Bank*, 722 F. Supp. 2d 875, 905–10 (W.D. Mich. 2010), *aff'd*, 712 F.3d 917 (6th Cir. 2013) (“Adoption of a theory of aiding and abetting based on something less than actual knowledge would in essence abolish existing state law on secondary tort liability. Why would a plaintiff undertake to prove a conspiracy to defraud, which requires proof of pursuit of a common scheme by clear and convincing evidence, when plaintiff can invoke an aiding-and-abetting theory, requiring only proof by a preponderance of evidence that the defendant knew that ‘something’ a customer was doing was somehow wrongful? Adoption of a low standard of *scienter* would abolish 100 years of state tort law overnight. . . . In the commercial context, the close relationship between banks, lawyers, brokerage houses, accountants and their clients makes these entities inviting targets for lawsuits stemming from client wrongdoing. These institutions will always have more information about the client’s conduct than the general public, making them vulnerable to the hindsight accusation that they knew of the client’s wrongdoing or were willfully [sic] blind. Courts are unwilling to make such institutions the guarantors of their customers’ conduct.”).

148. Peter T. Wendel, *The Evolution of the Law of Trustee’s Powers and Third Party Liability for Participating in a Breach of Trust: An Economic Analysis*, 35 SETON HALL L. REV. 971, 1002 (2005).

149. Sarbanes–Oxley Act of 2002, § 307, Pub. L. No. 107–204, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7245 (2012)); Puri, *supra* note 71, at 149–50.

beneficiary relationship: it appears that under the Uniform Trust Code (UTC)—which has been adopted in at least twenty-five states<sup>150</sup>—“constructive notice” on the part of the third party may be sufficient to give rise to liability.<sup>151</sup> However, there are some historical reasons why a higher level of protection from third parties may be justified for trusts.<sup>152</sup> In light

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150. As of June 2016, it had been enacted by 31 states, including the District of Columbia. *Acts: Trust Code*, UNIFORM LAWS COMMISSION, <http://www.uniformlaws.org/Act.aspx?title=Trust%20Code> [<https://perma.cc/AGB6-EPG9>] (last visited June 19, 2016). It was also i

151. UTC § 1012(a) provides that third parties will not be liable if they in good faith assist a trustee without knowledge that the trustee is breaching its duties. UNIF. TRUST CODE § 1012(a) (UNIF. LAW COMM’N 2000). Under UTC § 104, “knowledge” is defined to include where the person “from all the facts and circumstances known to the person at the time in question, has reason to know it. UNIF. TRUST CODE § 104 (UNIF. LAW COMM’N 2000). Accordingly, while the UTC provision is expressed in the negative (as a defense rather than a cause of action), it suggests that third parties who assist in a breach of a trustee’s fiduciary duty may be liable if they do so with constructive notice, and not in “good faith.” UNIF. TRUST CODE § 1012(a) (UNIF. LAW COMM’N 2000). The practical effect of the constructive notice provisions is that when third parties are put on notice, or have reason to suspect, that a trustee is acting in breach of fiduciary duties, they will have a duty to inquire. Wendel, *supra* note 148, at 973. As a result, the beneficiary in the Trust Scenario may be more readily able to establish that the accountant is liable than the other partners in the partnership scenario because a lower degree of knowledge is likely to be required. *See id.* This may also reflect the position at common law: the Restatement (Third) of Trusts § 108(1) says “reason to know that the trustee is acting improperly” will be sufficient constructive knowledge to establish liability, while Bogert states that the requisite constructive notice is “notice of facts which should charge him with such knowledge because they imposed a duty to inquire into the legality of the transaction and a reasonable inquiry would have disclosed the impending breach of duty.” RESTATEMENT (THIRD) OF TRUSTS § 108(1) (AM. LAW INST. 2012); BOGERT ET AL., *supra* note 49, ch. 43, § 901. Surprisingly, there does not appear to have been any judicial or academic commentary exploring whether there is any justification for holding third parties who assist in breaches of a trustee’s fiduciary duty to a higher standard than third parties who assist in breaches of fiduciary duties by other fiduciaries.

152. This distinction could be justified on the basis that a beneficiary’s ability to monitor and control trustees is typically less in trust relationships than other types of fiduciary relationships. Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 450 (1998). For example, in a private family trust, the settlor and the beneficiary may not have the ability to monitor the trustee, particularly if the settlor is dead and the beneficiary is a child or incompetent. *Id.* Trustees of private family trusts are often friends or family who are not paid and may not have special skills or advisors, and therefore may require additional protection. Tritt, *supra* note 130, at 2611–12. In addition, compared with many other fiduciary relationships, the beneficiary (as well as the settlor) has limited rights against the trustee and does not appoint the trustee. *See id.* at 2604–05. While the settlor creates the terms of the trust, and the beneficiary has rights to enforce those terms, they otherwise lack control over the trustee’s actions. *Id.* As the trust is the original and archetypal fiduciary relationship, it could be argued that it most reflects the features of the fiduciary relationship discussed in Part I (power imbalance, vulnerability, trust and confidence, etc.) and that as a result, requires even greater protection.

of the development of the modern commercial trust, it is not clear that these reasons provide sufficient justification for distinguishing between third party liability for breaches of trust and other fiduciary duties.<sup>153</sup> Alternatively, if there are certain relationships that policy makers believe do not need the same level of protection, the knowledge requirement could be increased to require “intention” or “bad faith” on the part of the third party.

### *B. Assistance*

In the states that have recognized third party liability, generally, plaintiffs must establish that the third party provided “substantial assistance” to the defaulting fiduciary.<sup>154</sup> Due to uncertainty surrounding what constitutes “substantial assistance,” the Restatement (Second) of Torts developed a five-factor test to determine whether substantial assistance has been provided, to which *Halberstam v. Welch*<sup>155</sup> added an additional factor. These factors are: (1) the nature of the wrong encouraged; (2) the amount and kind of assistance given; (3) the third party’s absence or presence at the time of the tort; (4) the third party’s relation to the primary wrongdoer—for example, if

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153. Imposing a higher standard on third parties in the trust context would effectively impose a duty upon them to inquire. Under the traditional trust model, the costs of a duty to inquire were relatively low. Wendel, *supra* note 148, at 995. This is because the role of the trustees was to preserve property and this duty did not arise often because the trustees had minimal dealings with third parties, and any dealings that did occur were typically conducted face to face which made the duty to inquire less onerous on third parties. *Id.* Further, the costs of a breach of trust could be high, as trusts often held significant family assets such as ancestral land. *Id.* However, changes in the use of the trust mean that this no longer holds true. Nowadays, transactions involving trusts are frequent and often need to be conducted under time pressures. *Id.* at 996–97. These changes led Fratcher to note that a duty of inquiry “impedes the effective administration of every trust by delaying transactions and discouraging dealings with and assistance to trustees.” *Id.* at 998 (citing William F. Fratcher, *Trustees’ Powers Legislation*, 37 N.Y.U. L. REV. 627, 663 (1962)). The cost of breach is also likely to be lower: as Wendel notes, the modern trust typically holds a diverse portfolio of assets rather than one asset (such as family property). Wendel, *supra* note 148, at 998. In addition, the likelihood that a transaction by a trustee will be a breach is also lower, reflecting that the purpose of the trust has shifted from property protection to asset management and that professional trustees, rather than unskilled family and friends, often act as trustees. *Id.* at 999. For these reasons, there do not appear to be any strong justifications for holding third parties who deal with trustees to a higher standard than other fiduciaries.

154. See, e.g., *Kaufman v. Cohen*, 760 N.Y.S.2d 157, 170 (App. Div. 2003) (“A person knowingly participates in a breach of fiduciary duty only when he or she provides ‘substantial assistance’ to the primary violator.”).

155. 705 F.2d 472, 483–84 (D.C. Cir. 1983).

they are in a position of authority their assistance may have more impact; (5) the third party's state of mind; and (6) the duration of the assistance.<sup>156</sup>

Many of these factors seem irrelevant. For example, the third party's state of mind seems unnecessary given the *knowledge* requirement discussed in Section A above. It is also difficult to understand why the third party's presence at the time of the tort should affect the assessment of whether the assistance was substantial. In fact, only the second factor—the amount and kind of assistance—seems to have any direct relation to determining whether assistance should be substantial. As a result, courts and legislators should think carefully before adopting this six-factor test. To avoid confusion, it may be preferable to adopt the description of “substantial assistance” used by New York courts, which occurs when the third party “affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the breach to occur.”<sup>157</sup>

One issue that has not received much attention is whether proof of *assistance* should be required when the third party has induced or procured the breach of fiduciary duty but has not otherwise provided any assistance. For example, a third party might strongly encourage a fiduciary to breach their fiduciary duties without providing any other *assistance* to enable the fiduciary to do so. In light of the purpose of TPLFD to protect the fiduciary relationship, the beneficiary's proprietary interests, and exploitation of vulnerability for gain, it is reasonable that the third party should be held liable in these circumstances. There are a few ways that this could be achieved. One option is for the definition of *assistance* in the TPLFD test to be expanded to include inducing or procuring a breach. Another option is to state the third party must provide “substantial assistance *or* induce or procure the breach.” Alternatively, the balancing test set out below could be adopted.

### C. Should Knowledge and Assistance Be Balanced?

Instead of evaluating the *knowledge* and *assistance* elements separately, some commentators and courts have endorsed a “sliding scale” approach that requires a court to balance the third parties' degree of knowledge against the level of assistance they provide.<sup>158</sup> Under the sliding scale approach,

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156. *Id.*; RESTATEMENT (SECOND) OF TORTS § 876(b) cmt. d (AM. LAW INST. 1977).

157. *Kaufman*, 760 N.Y.S.2d at 170; *see also In re Sharp Int'l Corp.*, 403 F.3d 43, 50 (2d Cir. 2005) (citing *Kaufman*, 760 N.Y.S.2d at 170).

158. *See, e.g., Court Appointed Receiver of Lancer Offshore, Inc. v. Citco Group Ltd.*, No. 05-60080-CIV, 2008 WL 926513, at \*4–5 (S.D. Fla. Mar. 31, 2008) (“Underlying the ‘substantial assistance’ prong is a single scienter requirement that varies on a sliding scale from ‘recklessness’ to ‘conscious intent.’ . . . When no duty of disclosure is alleged, an alleged aider-abettor may be found liable only if scienter of the high ‘conscious intent’

“[w]here assistance is not clearly established, the plaintiff must present more conclusive proof of knowledge, and vice versa.”<sup>159</sup> This approach would provide greater flexibility to the courts. For example, it may enable the courts to address the concern above that third parties who procure or induce a fiduciary breach without providing affirmative assistance may not be held liable, as these parties would have a high degree of knowledge despite not providing any material assistance. However, it may also lead to increased uncertainty—how should knowledge be balanced against assistance?—which may encourage third parties to overinvest in compliance costs and other precautions, which in turn may be passed on to innocent parties, or deter them from providing certain services. It is beyond the scope of this Article to determine whether a balancing test is appropriate. However, if states were to adopt a balancing test, the state legislatures should provide useful guidance to the courts on how to apply that test to reduce the risks noted above.

#### *D. Privileges*

One controversial issue that has arisen in relation to TPLFD is whether a privilege should apply to excuse some third parties, particularly attorneys, from liability. It has been argued that holding attorneys liable in these circumstances may “chill” attorney-client communications,<sup>160</sup> which conflicts with “[t]he need for attorneys to act on an informed basis [which] is at the heart of one of the bar’s most valued ethical principles—the attorney–client privilege.”<sup>161</sup> Attorneys may not feel free to provide frank legal advice due

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variety can be shown. . . . If it is alleged that a defendant has a duty to disclose, liability could be imposed if he acts with a lesser degree of scienter. . . . When an allegation combines inaction with affirmative assistance, the degree of knowledge required depends upon how ordinary the assisting activity is in the involved businesses.” (citations omitted)); *Witzman v. Lehrman, Lehrman & Flom*, 601 N.W.2d 179, 188 (Minn. 1999) (“Having concluded that Witzman alleged sufficient facts to establish the first element of an aiding and abetting claim, we must now look to the sufficiency of her allegations with respect to the remaining two elements of that claim—knowledge and substantial assistance. ‘We evaluate [these elements] in tandem.’ . . . Thus, ‘where there is a minimal showing of substantial assistance, a greater showing of scienter is required.’ . . .” (first quoting *In re TMJ Implants Products Liability Litigation*, 113 F.3d 1484, 1495 (8th Cir.1997); and then *Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991)).

159. Willis, *supra* note 146, at 398.

160. *Granewich v. Harding*, 945 P.2d 1067, 1074 (Or. Ct. App. 1997) (“The giving of professional advice will be ‘chilled’ by the knowledge that liability could result to those outside the professional relationship.”).

161. Fisch & Rosen, *supra* note 60, at 1128.



the concern they may face “personal liability to third persons if the advice later goes awry.”<sup>162</sup> Another concern is that TPLFD may require disclosure of confidential attorney–client communications, as attorneys may need to disclose privileged communications in order to defend themselves.<sup>163</sup> TPLFD creates a conflict of interest, as attorneys may not be able “serve their clients adequately when their own self-interest—in these examples, the need to protect themselves from potential tort claims by third parties—pulls in the opposite direction.”<sup>164</sup> It may also require attorneys to monitor client actions to avoid liability, which may “infringe on the authority of clients to determine the extent and goals of the attorney–client relationship” and undermine attorney’s role as advocate and advisor.<sup>165</sup> However, there is a competing policy interest in ensuring that lawyers are not “free to substantially assist their clients in committing tortious acts.”<sup>166</sup>

There appear to be three potential approaches to addressing this issue. First, courts could make a limited exception to TPLFD for attorneys, and potentially other types of professional agents. This approach is reflected in the Supreme Court of Oregon’s decision in *Reynolds v. Schrock*. In this case, the court held that the privilege did exist, but it only applied where the attorney was acting within the scope of the attorney–client relationship and actions “that permissibly may be taken by lawyers in the course of representing their clients. It does not protect lawyer conduct that is unrelated to the representation of a client.”<sup>167</sup> In addition, the court held that the privilege “does not protect lawyers who are representing clients but who act only in their own self-interest and contrary to their clients’ interest” or “actions by a lawyer that fall within the ‘crime or fraud’ exception to the lawyer–client privilege, OEC 503(4)(a), and Rule of Professional Conduct 1.6(b)(1).”<sup>168</sup>

Another approach is to hold third parties who derive some benefit, other than remuneration, from the breach to a higher standard than third party agents, such as accountants or lawyers, who simply provide agency services to a fiduciary without receiving any direct benefit, other than remuneration (mere agents).<sup>169</sup> For example, if in the Trust Scenario the accountant received a portion of the trust funds, it may be more appropriate to hold the accountant liable than if the accountant had received no personal benefit

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162. *Chem-Age Indus., Inc. v. Glover*, 652 N.W.2d 756, 774 (S.D. 2002).

163. *Granewich*, 945 P.2d at 1074; *Reynolds v. Schrock*, 107 P.3d 52, 59 (Or. Ct. App. 2005), *rev’d*, 142 P.3d 1062 (Or. 2006).

164. *Reynolds v. Schrock*, 142 P.3d 1062, 1068 (Or. 2006).

165. *Granewich*, 945 P.2d at 1074.

166. *Glover*, 652 N.W.2d at 774.

167. *Reynolds*, 142 P.3d at 1069.

168. *Id.*

169. This approach has been suggested in the English and Australian context. *See Ridge*, *supra* note 49, at 133–39.

from siphoning the trust funds other than standard remuneration for his or her work. This could be achieved either by requiring that mere agents have a higher degree of knowledge to be found liable—only actual knowledge rather than willful blindness—or alternatively requiring that the mere agent act in “bad faith” or with “intent” in order to be liable.

Finally, the third approach is to apply the knowledge and assistance requirements outlined in Sections A and B above strictly. The Oregon Court of Appeals adopted this approach in *Reynolds v. Schrock* on the basis that “strict and narrow construction best protects the attorney–client relationship without conferring on attorneys a license to help fiduciaries breach their duties.”<sup>170</sup> This approach was subsequently rejected by the Oregon Supreme Court on the basis that it provided “insufficient guidance to lawyers and lower courts” and drew an artificial distinction between a lawyer’s advice to a client and the lawyer’s other assistance to a client.<sup>171</sup> However, it is not clear that these criticisms were warranted. Under the strict approach, attorneys will only be liable if they have actual knowledge—literal or implied—or under my proposal, are willfully blind to the relevant breach and provide substantial assistance. Simply providing legal advice would not be enough to give rise to liability.<sup>172</sup> In addition, the test does not require attorneys to actively monitor for wrongdoing, or to notify a third party if they discover it. To avoid liability, attorneys must avoid providing substantial assistance in the wrongdoing and not induce any wrongdoing. In fact, attorneys will generally be better placed to be able to identify potential breaches of fiduciary duty and contract, and explain the possible consequences of that conduct to their clients than other third parties. As a result, they may be in a better position to deter wrongdoing than many other third parties.

While the approaches outlined above have their advantages and disadvantages, whichever approach is taken should not permit attorneys to escape liability where they receive a personal benefit from the breach other than normal remuneration—in which case the beneficiary should be able to recover those gains in furtherance of the objective of TPLFD to

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170. *Reynolds v. Schrock*, 107 P.3d 52, 59 (Or. Ct. App. 2005), *rev’d*, 142 P.3d 1062 (Or. 2006).

171. *Reynolds*, 142 P.3d at 1070.

172. *Witzman v. Lehrman*, Lehrman & Flom, 601 N.W.2d 179, 188–89 (Minn. 1999) (“[i]n addressing aiding and abetting liability in cases involving professionals, most courts have recognized that “substantial assistance” means something more than the provision of routine professional services.” (citing *Spinner*, 631 N.E.2d 542, 546 (Mass. 1994))).

prevent exploitation for gain, discussed in Part I—or intentionally or with bad faith procure or induce the breach.

### *E. Remedies*

If liability is established, third parties are generally held jointly and severally liable with the fiduciary for losses arising out of the relevant breach,<sup>173</sup> and may also be liable for any profits made from the breach.<sup>174</sup> However, issues such as whether third parties may be liable for punitive damages,<sup>175</sup> or damages for emotional distress,<sup>176</sup> or whether they should be held liable for the profits of the fiduciary have not been adequately explored. In addition, the ability of third parties held liable to receive contribution from defaulting fiduciaries is unclear.<sup>177</sup> If a legislative test was adopted, this would provide an excellent opportunity for the legislature to clearly set out the remedies available and whether any contribution or proportionate liability regime should apply. The courts should have broad discretion to award a wide range of compensation and gains-based remedies to ensure TPLFD achieves the objectives discussed in Part I.

## V. CONCLUSION

While more jurisdictions are recognizing TPLFD, there has been little analysis of whether this cause of action *should* be adopted and, if so, how. Part I argued that there are strong justifications for adopting this form of liability in each U.S. jurisdiction unless existing causes of action provide

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173. Wechsler v. Bowman, 34 N.E.2d 322, 326 (N.Y. 1941).

174. RESTATEMENT (SECOND) OF TORTS § 874 cmt. c (AM. LAW INST. 1977).

175. It has been held that fiduciaries may be liable for punitive damages in some situations. See, e.g., *In re Marriage of Pagano*, 607 N.E.2d 1242, 1249–50 (Ill. 1992), *superseded by statute*, 735 ILL. COMP. STAT. 5/2-1115 (2016) (“Punitive damages are *permissible* where a duty based on a relationship of trust is violated, the fraud is gross, or malice or willfulness are shown; such an award is not automatic.”).

176. For example, in a Minnesota Court of Appeals case, it was held that fiduciaries were not liable for emotional distress: *R.E.R. v. J.G.*, 552 N.W.2d 27, 30–31 (Minn. Ct. App. 1996) (“We decline to expand the remedies available for the breach of a fiduciary duty to include emotional distress and any resulting monetary damages.”). This suggests that third parties may not be either.

177. In one recent interesting case, *RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 872 (Del. 2015), the Delaware Supreme Court held that directors who were exculpated from monetary damages under 8 Del. C. Section 102(b)(7) could not be considered “joint tortfeasors” under the Delaware Uniform Contribution Among Tortfeasors Acts. For a discussion of these issues in an Australian context, see Alison Gurr, *Accessory Liability and Contribution, Release and Apportionment*, 34 MELB. U. L. REV. 481, 486–90 (2010). For the discussion in the context of contribution between fiduciaries, see J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 73–77 (2010).

sufficient protection to beneficiaries. An examination of common alternative causes of action in Part II suggested that these existing causes of action may not adequately achieve the deterrent and compensatory aims of TPLFD. As a result, there are persuasive reasons for this cause of action being recognized in all U.S. states. Part III argued that this recognition should be brought about through legislative action rather than relying on the courts to introduce the cause of action using methods of judicial reasoning that may be seen as illegitimate.

Finally, Part IV set out some key issues that legislators and, if relevant, the courts, should be aware of when introducing this cause of action. In particular, the *knowledge* and *assistance* elements of the test for liability must be carefully crafted to avoid the risks of excessive compliance costs and over-deterrence from imposing TPLFD. Courts and legislatures should give thought to whether third parties who assist in a breach of particular fiduciary relationships—such as the trustee-beneficiary relationship—should be held to a higher standard than third parties who assist in breaches of fiduciary duty by other types of fiduciaries. Legislators should also be skeptical of calls to exclude certain third parties—such as attorneys—from liability, and should ensure that any exception is drafted to ensure third parties who assist and benefit from a breach of fiduciary duty or intentionally procure or induce a breach of fiduciary duty are held liable. Finally, legislators should take the opportunity to clearly set out the remedies available to plaintiffs who successfully establish TPLFD.

